ECONOMIC ENVIRONMENT
AND
HUMAN RESOURCE MANAGEMENT

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PREFACE

The present research volume is a compilation of papers pertaining to the thrust area, Economic Environment and Human Resource Management, which seeks to merge two different, albeit closely related contemporary, issues. There may arise considerable debate as to the tenuous connection between these two research themes and their sequencing in terms of the priority of the issues—quality of human beings in a society as a determinant of the quality of economic-transactions, or vice versa. As a necessary clarification, we state that the two research themes in question and their ordering in this volume are based strictly on the nomenclature of the third thrust area prescribed for the purpose of research under the Second Phase of the Special Assistance Programme in Commerce granted by the University Grants Commission.

The volume presents the reader with fourteen research-based papers, evenly distributed between the twin research themes that fall under the thrust area. Indeed, they focus on varied aspects of the somewhat broadly defined thrust area. Most of the papers, if not all, are carved out of presentations made at the 3rd National Conference of the DSA Programme in Commerce (2nd Phase) held during March 23-24, 2002.

The Conference was inaugurated by the Vice-Chancellor of the University of Calcutta, Professor Asis Kumar Banerjee, who stressed on the need for integration of the themes for meaningful academic interactions. Professor D. N. Rao, Centre for Economic Studies and Planning, School of Social Sciences, Jawaharlal Nehru University, and a UGC Expert on the Advisory Committee, spoke as the Chief Guest. He elaborated the concept of human resources, the fallacy of rate of return approach, limitation of the human capital approach and HRM in the context of globalization. Two keynote addresses were given on the themes respectively by Professor P. N. Ray, Member, State Planning Board, Government of West Bengal, and Professor K. K. Chaudhuri, Director, National Institute of Management Calcutta. While Professor Roy dwelt on "Impact of Globalization on Indian Economy" in a comprehensive and lucid way, Professor Chaudhuri highlighted the issues in HRM and the actions needed on the part of management. These two thought-provoking lectures set the tone of discussion in the subsequent sessions dealing with two themes of Economic Environment and Human Resource Management. The other distinguished speakers included Professor Suranjan Das, Pro-Vice Chancellor for Academic Affairs, University of Calcutta, Professor Ranajit K. Chakraborty, Dean of the Faculty of Commerce, Social Welfare and

Business Management, University of Calcutta. Professor Arun Kumar Datta Gupta, former Dean of Commerce, Social Welfare and Business Management, University of Calcutta, Professor Shirin Rathore, Dean of the Faculty of Financial Studies, University of Delhi (South Campus) and Professor S. K. Chakraborty, Management Centre for Human Values, Indian Institute of Management Calcutta.

There is no doubt that the deliberations that had taken place in the Conference helped the authors significantly to revise their papers. Of course, the papers as we see them in their present form, are a culmination of several rounds of revision, enhancement and enrichment subsequent to a blind review of all of them by experts in terms of both content and the style of presentation.

There are seven papers under the theme "Economic Environment". The first one is by Mahalaya Chatterjee, which seeks to deliberate upon the significant impacts of the new economic policy on the Indian economy over the last decade. With the help of data drawn primarily from official sources, critical sectoral issues are examined, especially agriculture, industry, labour market, information technology, and international trade.

The second paper by Pabitra Giri conceptualises an economic environment by identifying the key factors that characterise the economic environment of a country, as a frame of reference for analysing the changes in the Indian economic environment in the post-reform period. The author concludes that the increasing market orientation of the Indian economy has ushered in its wake greater risks and uncertainty.

Dipti Kumar Chakravorty then makes a case for Indian public sector enterprises (PSEs) in the emerging economic scenario where privatisation appears to rule the roost. With the help of data, Chakravorty argues that privatisation of enterprises might dampen the Indian economy because of the pervasive phenomenon of poverty, and because of the PSEs capacity to achieve social objectives, with a total factor productivity that is higher than that of the private sector enterprises.

Jita Bhattacharyya handles deftly the crucial issue of foreign direct investment (FDI) and its role in shaping not only the capital market but also the economy as a whole. The author discusses the importance of FDI in India as a source of foreign capital to combat the shortage of financial resources as well as technologies and skills. India's FDI policy in the pre- and post-reform periods are analysed and the conditions conducive to inflow of FDI as also the problems associated with FDI in India are examined.

The fifth paper by Swagata Sen calls for a fresh look at the existing financial reporting system in the context of challenges and opportunities raised by the new economy that is rooted in intellectual capital and powered

by revolutionary developments in information and communications technologies. Sen makes an earnest attempt to clarify the significant issues before the financial reporting function that need to be addressed. In this connection, notable international efforts and initiatives to cope with the emerging challenges are reviewed, as also the Indian response to these challenges.

Ranajoy Bhattacharyya traces the developments in the exchange rate regime in India during the 1990s. The author points out that it was neither the introduction of LERMS, nor the introduction of full convertibility in the Current Account that have significantly influenced the exchange rate. Instead, the exchange rate was fully adjusted by the two major policies of devaluation in July 1991 and trade account convertibility of February 1993.

Malay Gupta considers the problems and prospects associated with the Indian banking sector, which is by far, the most dominant element of the Indian financial system. The author contrasts the pattern of growth in Indian banking in the nationalisation and liberalisation eras. The major areas of performance improvement of banks as proposed in the two-phase recommendations of the Narsimham Committee are discussed with particular reference to risk management.

The wide horizon of the theme of "Human Resource Management" embracing diverse issues of universal relevance is covered by seven paper-writers. Rajib Dasgupta sets the right note for managing human resources in the context of a changing environment, primarily in the realm of manpower planning. In doing so, the author suggests that at a time when the winds of change in the corporate world beg for more judicious use of all resources, intrapreneuring rather than downsizing would serve as a more meaningful, humane and mutually beneficial long-term solution.

In attempting to highlight the significant human resource dimension in a total quality environment, Dhrubaranjan Dandapat takes a cue from Deming, the well-known quality expert, to underscore the importance of "good" people, and people who are improving, for the survival and competitiveness of organisations. The author suggests that the three elements of human resource effectiveness—skills, abilities, and knowledge—may be improved effectively through continuous training and education.

Malayendu Saha takes a strategic approach to human resource management (HRM) to point out that the excellence of people is a pivotal factor for organisational excellence as well as for the achievement of competitive advantage. In this regard, he suggests that human resource accounting represents a unique opportunity of enriching HRM practices by

identifying and measuring human resources and communicating this information to interested users.

Srutinath Praharaj highlights the significance of creativity as an essential factor for effectiveness of work performance and enhancement in the quality of life of organisational workers. By means of an empirical study based on executives in the government departments of West Bengal, he infers that the government departments should work towards building more stimulating environments to foster human creativity, and top management should enable a more open work culture. In the interest of encouraging creativity necessary organisational restructuring, continuous training, increase in intellectual diversity, and greater autonomy should be brought about.

The paper by Kanika Chatterjee reminds us that we live in a time of decision being faced by the hard choice of survival or destruction. Sure enough, there is urgency for an intellectual revolution from knowledge to wisdom. Business leaders of the future must model themselves on whole-brain, wisdom leadership with holistic wisdom instead of fragmentary knowledge as the starting point of leadership. Hence, the author asks for a substitution of the traditional concept of human resource management with human potential management (HPM), which denotes an integrative process of enhancing human capabilities through enrichment of existing human potential and inspiration for discovery and realisation of all latent potential. The wisdom leader, through the power of silence, intuition and progressive ascent towards the Higher Self, can lead humanity through the supreme task of inspirational motivation, to realise the flow of *atmikshakti* within the various *kosas* or sheaths of the being.

Ratna Sen discuses the outcome of an industrial relations research project—South Asia and Vietnam Project on Tripartism (SAVPOT)—in the context of globalization. The project was an ILO action research programme funded by the Norwegian Government to enlarge the ambit of labour management consultation within enterprises. The basic objective of the project that started in 1999 and is still under way was to supplement collective bargaining with consultation or dialogue among management and labour/unions at the enterprise level. The pilot phase of the project was completed in mid-2001.

Sharmistha Banerjee's paper is based on a survey covering the problems faced in designing an objective performance-based incentive scheme in the hotel industry in Kolkata. In this regard, she explicitly assumes that incentive schemes function best when they are related to the efforts of personal employment in an organization. As an integral part of the study, Banerjee has attempted to formulate a performance-related

incentive scheme incorporating three tools—Guest Compliments, Distinction Cards, and Suggestion Schemes. As incentives, the paper suggests titles of honour in the nature of Star, Nova or Super Nova as a way of recognition of the services of the employee's endeavour. According to her, the suggested schemes may well be modified to suit the needs of other units in the service sector.

We express our gratitude to the authorities of the University Grants Commission, New Delhi, for funding the publication of the present volume. We are deeply indebted to the Vice-Chancellor, Professor Asis Kumar Banerjee, for his encouragement and support. He has favoured us with a Foreword to this volume. Thanks are also due to the authors for their contributions and to other colleagues in the Department for their constant encouragement and support in the form of review of papers. We are also grateful to two external reviewers – Professor Arun Kumar Datta Gupta, formerly of the University of Calcutta, and Professor Rama Prasad Banerjee, Eastern Institute for Integrated Learning in Management, Kolkata, who helped the authors to enrich their contributions by their valuable comments. Last but not least, we record our appreciation for publication of the volume by M/s Ajanta Printers within a given time frame and budget limit.

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Foreword

It gives me great pleasure to write this foreword to 'Economic Environment and Human Resource Management', a research volume that relates to one of the thrust areas of the Special Assistance Programme (Second Phase) of the UGC in the Department of Commerce.

Economic Environment and Human Resource Management are two distinct themes. Their integration into one research volume will promote interesting academic interactions. There is no doubt that economic environment and human resource management are complementary to each other.

This volume contains many research papers in emerging areas of economic environment and human resource management contributed mostly by the faculty members of the Department of Commerce. Their efforts are praise-worthy.

I wish this volume would promote further interactions and research on the subjects.

A. K. Banerjee

Prof. Asis Kumar Banerjee
Vice-Chancellor
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Economic Environment & Human Resource Management

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THE ECONOMIC ENVIRONMENT OF INDIA : A DECADE OF THE NEW ECONOMIC POLICY

MAHALAYA CHATTERJEE

1. INTRODUCTION

The New Economic Policy was adopted in 1991 when the Congress Party came into power with a thumping majority. Though P.V. Narsimha Rao was the prime minister, the main architect of the New Economic Policy was the then Finance Minister, Dr. Manmohan Singh, a noted economist. The main thrust of this policy was LPG, i.e. Liberalisation, Privatisation and Globalisation. A decade has passed since then. There has been a lot of change in the political scenario of India. The Congress Party lost his supremacy in the national politics. There have been unsuccessful experiments with coalition governments, and presently the National Democratic Alliance is in power at the Centre. The Bharatiya Janata Party (BJP) with more than twenty political parties of different strength and ideologies as their partners maintains a working majority. But this change in the political ideology has not affected the so-called reform process at the national level. Though some of the mass organisations of the BJP sometimes talk of 'swadeshi', the real experience is that the NDA government is more vigorous with the reforms than the previous Congress or United Front Coalition governments.

There are also some noticeable changes in the international scenario. There has been a remarkable slowdown of the US economy, reflected in the different indices of the share markets and the East Asian Miracle has been changed to East Asian Debacle. The World Bank introduced the Structural Adjustment Programme (SAP) in many countries of the world in 1980. This was accompanied by the Stabilisation Programme of the IMF. It requires no separate mentioning that these two organisations believed in the same economic philosophy. But the second half of the 1990s was dominated by a new international organisation, the World trade Organisation (WTO). It was formed in 1995 as the outcome of the GATT negotiations, concluding in the Marakesh agreement. There were different agreements signed on intellectual property rights (TRIPS), investment (TRIM) and services (GATS). They required time-bound implementation of the programme by their member countries by phases within definite time-period and non-implementation was punishable by a dispute-

settlement body. Thus the WTO is likely to become a super-state by-passing other specialised UN bodies. The standards set by WTO were not strictly on trade-related issues.

Now, in view of these changes worldwide and the performance of the Indian economy over the last ten years, the time has come to introspect some of the important economic issues of the country. In this paper, we propose to look into the following issues :

- Agriculture and food security
- Industrial production and labour standard
- The fiscal question
- Capital account convertibility and
- New horizons of growth

The paper is organised into seven sections. After the introductory section, the next five sections deal with the five issues listed above. The concluding comments are in the seventh section.

2. AGRICULTURE AND FOOD SECURITY IN INDIA

In this section, we would like to look into the performance of the agricultural sector in the last decade, in the light of some common indicators. Let us start with total land under cultivation. India enjoys an enormous advantage over any other country on the globe in terms of availability of land area. Some other countries like China may have a larger land area, but the total arable area is smaller because of rocky terrain. But a look at Table 1 will show that there is no significant change in the land use pattern in the macro-level, except for the fact that there is a very small increase in the percentage of land under plantation.

TABLE 1

Land Use in India

Total land area (in '000 sq. km.)	Arable land as % of total land area		Permanent cropland as % of total land		Other uses of land as % of total land	
	1980	1997	1980	1997	1980	1997
2973	54.8	54.5	1.8	2.7	43.4	42.8

Source : Calculated from Dasgupta and Ghosh, Table 1.

Here we should remember that the proponents of globalisation opined that India's comparative advantage lied in agriculture. So, Indian agriculture would change towards more export orientation like horticulture,

plantation products etc. But as we can see as far as land use pattern is concerned there is no significant change even in 1997.

The next issue is about the price of crops. The support prices of different crops were increased considerably during this period. This was mainly to make agriculture a more attractive and remunerative activity than ever before. Three important committees were set up in the eighties, chaired by C.H. Hanumant Rao, Sharad Joshi and Bhanu Pratap Singh. All these three reports opined that agriculture should be treated as an industry. The main objective would be to maximise profit. The old idea that for Indian farmer, agriculture is a way of life, with subsistence production, should be changed as soon as possible. So, we can see from Table 2, that within ten years, the minimum support price declared by the Commission for Agricultural Cost and Prices (CACP) was increased more than twice. It should be remembered the 'food problem' of the sixties was no more. The country has a massive reserve of food stock. A network of public distribution system took care of the hunger problem. And now the new issue is about the cost of holding such a massive food stock. In fact, sometimes, one hears about rotting of foodgrain in Food Corporation of India warehouses and plans to throw them away in the deep sea.

TABLE 2

Minimum Support Price Declared by CACP

(Rupees per quintal)

Year	Paddy Common	Wheat	Sugarcane	Coarse Cereals
1980-81	105	117	13	105
1990-91	205	225	23	180
1995-96	360	360	42.5	300
1990-00	490	550	56.1	415
2000-01	510	580	–	445

Source : Calculated from Dasgupta and Ghosh, Table 2.

Next, we would like to look into agriculture production. Here we would like to study the performance of the major food crops, cash crops and plantations crops. For the sake of comparison, we are taking the decade before 1991, i.e.1980-81 to 1990-91 as period I, and the decade after it, i.e. 1990-91 to 2000-01 as period II. Table 3 gives an idea about the percentage growth rates in the two periods.

TABLE 3

Production of Food Crops, Cash Crops & Plantation Crops (1980-2000)

(Percentage Growth Rate)

Food Crops				
Period	Foodgrains	Rice	Wheat	Pulses
I	36.11	38.62	51.79	34.91
II	24.05	19.81	35.73	11.67
Cash Crops				
Period	Oilseeds	Sugarcane	Cotton	Jute & Mesta
I	97.87	56.29	40.00	12.20
II	12.37	17.00	19.59	1.94
Plantation Crops				
Period	Tea	Coffee	Rubber	
I	66.67	100.00	50.00	
II	N.A.	50.00	50.00	

Source : Calculated from Dasgupta and Ghosh, Table 3, 4 & 5.

The table very clearly shows that the growth rate for all the major crops have declined in period II, i.e. in the period of the new economic policy. It has remained constant only for rubber. So, though agricultural production has increased in absolute terms, its growth rate has slowed down considerably. As we shall see later, this has been reflected in per capita food availability. The slowing down is also reflected in the next table, where we have comparative figures for the growth rate of the gross area under cultivation of the same crops.

TABLE 4

Gross Area Under Some Selected Crops

(Percentage Growth Rate)

Food crops					
Period	Food grains	Cereals	Rice	Wheat	Pulses
I	0.86	1.00	6.48	8.52	9.78
II	0.98	2.61	5.39	17.60	-5.78
Other Crops					
Period	Oilseeds	Sugarcane	Cotton		
I	36.93	37.04	-5.13		
II	-5.79	10.53	14.29		

Source : Calculated from Dasgupta and Ghosh, Table 6.

This table is again self-explanatory. We can see that in period I, there was a clear shift towards oilseeds and sugarcane. But, that trend is not sustained. The percentage growth rate of area for most of the crops, have decreased in the second period. The growth rate for area under pulses, have become negative in period II. This is alarming because pulses form an integral and important component of average Indian diet.

In the next table we would look into the growth rate of yield per hectare of the major crops.

TABLE 5

Yield per Hectare of Major Crops

(Percentage Growth Rate)

Period	Food grains	Cereals	Pulses	Rice	Wheat	Oilseeds	Cotton
I	34.90	37.56	22.00	30.24	39.94	44.92	48.40
II	22.94	13.68	18.20	13.65	15.08	8.22	4.63

Source : Calculated from Dasgupta and Ghosh, Table 8.

So, here also we find that there is a remarkable slowdown in agricultural productivity for almost all the crops during the last ten years. It is to be noted here that the agricultural productivity per hectare is already very low in India. In the regime of New Economic Policy, the growth rate of productivity has in fact decreased compared to the previous decade. This obviously has relationship with the government investment in agriculture. The percentage allocation of total budget for agriculture, irrigaticn and flood control and rural development have been decreased continuously in the last two decades, precisely from the Sixth Plan Period. The idea was that the short fall in public investment would be made up by an increase in the private investment. But this has not happened. On the contrary, it led to a decrease in demand. On the supply side, there has been noticeable decrease in per capita food availability.

TABLE 6

Growth of Per Capita Daily Availability of Food grains

(in per cent)

Period	Cereals	Pulses
I	14.78	34.63
II	7.43	12.02

Source : Calculated from Dasgupta and Ghosh, Table 10.

TABLE 7

Growth of Per Capita Availability of Some Basic Items of Consumption

(in per cent)

Period	Cloth	Edible Oil	Sugar	Tea
I	39.31	44.74	73.97	17.60
II	33.62	70.37	20.00	3.21

Source : Calculated from Dasgupta and Ghosh, Table 11.

These two tables clearly show that except for edible oil, per capita availability of most of the essential items of consumption including food items has decreased in the second period.

Inputs

The scenario for the use of essential inputs in agriculture is absolutely depressing. There has been reduction in use of HYV seeds, coverage of area under irrigation and also fertiliser consumption. The later has been mainly because of the withdrawal of subsidy. There is an increase of nitrogenous fertilisers at the cost of the more expensive potash and phosphate varieties. The growth of use of electricity in agriculture has also been reduced.

TABLE 8

Growth Rate of Various Inputs in Agriculture

(per cent)

Period	HYV seed	Irrigated Area	Fertiliser Use	Electricity Use
I	48.26	30.44	127.27	263.87
II	NA	16.35	42.52	- 73.25

Source : Calculated from Dasgupta and Ghosh, Table 12.

The only remarkable improvement in the agricultural sector in the last decade is the increase in disbursement of credit. The main sources of credit are cooperative and commercial and rural banks. The flow of credit to the rural sector through the apex organisation NABARD has almost doubled during the last five years. The introduction of Kishan Credit Card has also ensured smooth flow of credit. But as the Narasingham Committee is opposed to priority lending, how long this trend can be sustained, is to be seen.

Agricultural Exports

In this sector, the performance was expected to be good. The proponents of Structural Adjustment Programme proclaim that a developing country's comparative advantage lies in agriculture. So, agricultural exports are supposed to be the mainstay of Indian exports, earning enough to cover the cost of imports. But except for some traditional items like fruits and vegetables and coffee and non-traditional items like rice and fish (mainly shrimp), there is no remarkable increase of exports in the last decade. Again the share of India in these items in world export is quite negligible. In fact, India's agricultural export as percentage of total export has decreased remarkably, from 30.65 in 1980-81 to 15.08 in 1999-2000.

TABLE 9

Growth of Export of Some Agricultural Commodities

(per cent)

Period	Rice	Tea	Coffee	Fruits & Vegetables	Spices	Fish & Fish Preparations	Oilcakes
I	106.25	151.17	17.76	170.00	2072.73	342.40	110.40
II	310.71	45.71	310.84	244.32	331.98	254.40	325.20

Source : Calculated from Dasgupta and Ghosh, Table 17.

So, though the export of agricultural items, both traditional and non-traditional, has immense possibility, we are yet to exploit it. Though the performance of agricultural sector as such has been quite satisfactory, especially in the years of normal rainfall, at least, there is no remarkable effect of the New economic Policy in the sector. Specially, till now, there is no indication that the agricultural export sector will be able to carry on the whole economy on its own.

The issue of food security is intimately related to the performance of the agricultural sector. Again the proponents of the SAP, particularly Ann Krueger preach the philosophy of 'food security via trade'. The basis of that philosophy is that under globalised situation, self-reliance is no longer a necessity. A country should produce those commodities, agricultural or industrial, where it has a comparative advantage. So, the less developed countries should not spend enormous amounts from the public exchequer on subsidies on essential inputs like fertiliser and power. Competitive market should be allowed to take care of everything. The essential food items can be imported from the global market. But there are some serious flaws in this argument. Firstly, the rich countries have always gone for self-

sufficiency in food. Secondly, economic forces alone do not guide the global market. Sometimes, international political connections become crucial. As despite good harvest, there is some level of food insecurity in India, specifically in some typical pockets, India should think twice before going for some long-term changes in policy. Related to this, are the issues of the participation of multinational companies in agriculture, consequent effects on the environment and finally, the role of world food industry.

3. INDUSTRIAL PRODUCTION AND LABOUR STANDARD

After agriculture the next important sector of the economy is the industrial sector. In usual economic literature, there is a tendency to show that the relationship between these two sectors is somehow antagonistic. But for the growth and balanced development of any country, especially developing countries like India, balanced growth of both the sectors and a healthy symbiotic relationship are absolute necessity. We have seen in the previous section that there was no dramatic change in the agricultural sector in the last ten years. Though in the years of normal rainfall, agricultural production was up to the mark, and India could build up a huge reserve of food, there are indications that the growth rate has slowed down. There is also no remarkable change in the composition and volume and direction of agricultural exports. But on the whole, this sector has not let down the economy. On the other hand, in the industrial sector the growth rate has gone down drastically, which is evident from the next table.

TABLE 10

Rate of Industrial Growth in the Pre-reform and Post-reform Years

Pre-Reform Years		Post Reform Years	
Year	Rate of Industrial Growth	Year	Rate of Industrial Growth
'81-82	9.3	'91-92	0.6
'82-83	3.2	'92-93	2.3
'83-84	6.7	'93-94	5.2
'84-85	8.6	'94-95	10.2
'85-86	8.7	'95-96	11.6
'86-87	9.2	'96-97	7.1
'87-88	7.3	'97-98	4.3
'88-89	8.7	'98-99(P)	3.4
'89-90	8.6	'99-00(Q)	6.4
'90-91	8.3	'00-01(A)	6.6
mean	7.86	mean	5.77

Source : Calculated from Dasgupta, (2001), Tables 1 & 2.

So, we can see that the industrial sector of India did not perform very well in the post-reform years. Taking simple linear growth, we can see that the average of the pre-reform years was higher than that of post-reform years. Except for the years '94-95 and '95-96, the figures are much below the average of the pre-reform period. Even this may also be an under estimation as the figures for the last three years are not actual figures but provisional, quick and advanced estimates.

Now if we introspect into the reasons of the bad performance of this sector, we may have to go back to history. In the post-independence period, India vowed to be a self-reliant industrialised economy and the main thrust was on import substitution. The state apparently had an active role in industrialisation and this role was recognised in the industrial policy resolutions of 1948 and 1956. Most of the strategic and heavy industries were placed in the public sector. Later after the nationalisation of the banks in 1969, a major part of the financial sector was also under the control of the government. In late eighties, the public sector accounted for 27% of the GDP and 9.3% of gross savings and 48.1% of gross investment. It is to be noted that this extensive public sector acted in a co-operative manner with the private sector. Most of the public sector industries had vast capital requirements and long gestation periods. This made them unattractive for the private sector. Sometimes many sick private sector units were taken over by the public sector. On the other hand, the private sector was regulated by the licensing system, whereas the MRTP Act tried to control concentration. The protection from foreign competition was by various tools like high tariffs, quotas, 40% limit to foreign equity in the companies and import component requirements. This policy yielded positive results in the sense that the country achieved almost self-sufficiency in a number of industries like military hardware, refineries and a number of industrial items. The small industries were treated as labour-intensive and this sector was also protected from the large industries of the country itself. Despite these good indications, given the vast natural resource and skilled technical manpower, India's industrial performance was not at per with that of Japan or many other East Asian countries. The reasons may be given as follows. Firstly, land reform was not implemented in the major part of the country. So the demand for industrial products in the rural sector did not increase. Secondly, as a corollary of the first, the rural elite and rich, rather than the common people accessed most of the facilities made available in the rural sector. Thirdly, low priority was given to human development, which was reflected in the budgetary allocations of the central governments in education, health and sports. Lastly, India went for import substitution, but did not go for export promotion with the

same vigour. So, from the seventies, India started to fall behind the East Asian countries, in terms of industrial performance.

In 1991, a new industrial policy was formulated as a part of the Fund-Bank prescription. As we have noted earlier, the Structural Adjustment Programme and later WTO was against indigenous industry and labour. The potential gainers were supposed to be the agricultural sector in particular and the rural sector in general against the urban-industrial-bureaucratic group. Contrary to the old economic policy, the main thrust of the new one was on downsizing the public sector. Public ownership was allowed only in natural monopolies and strategic industries. The limit of public ownership in any enterprise was set to 26% only and the 40% limit to foreign participation was removed. The private sector was thus made the leading force in development. Disinvestments in public sector were proposed to make way for increased private sector participation. The banks were instructed to lower SLR and CRR to make more funds available for the private sector. A revitalised, fully computerised share market, operating under the SEBI, was expected to mobilise funds. Another major source of fund for the private sector was expected to come from Foreign Direct Investment. The private sector would have access to foreign capital directly by GDRs (Global Depository Receipts). Another aspect of the 1991 Industrial Policy was to do away with the 'License Raj'. The MRTP Act and the protection of small industries were almost scrapped. So, a deregulated industrial economy functioning within a framework of globalisation would lead to high growth. This would in turn take care of all the ills of the Indian economy in general.

However, as we have seen in Table 10, that instead of very high growth rate, we have ended up with an industrial growth rate, even lower than before. The index of industrial production has just tripled itself in these two decades (Table11).

So, now the question may be asked what went wrong? First, the policy of downsizing of the public sector can be scrutinised. Now, even the strongest admirer of the Indian public sector would hesitate to give it the full marks for its performance over the years. But at the same time all of its failures cannot be attributed to its ownership only. The efficiency of an enterprise is determined by the quality of its management. In this respect, Indian private sector was no better. In fact, the one of the reasons for the enormous expansion and increasing losses of the public sector can be attributed to the inclusion of sick and loss-making units of the private sector in the name of nationalisation and rehabilitation of the workers. The fact that India has been able to become self-sufficient in some of the industrial products, was due to the presence of this sector. The experience

of countries following *laissez-faire* in similar circumstances shows something else. The argument for privatisation was that the loss-making units would improve their efficiency. But disinvestments with revenue-raising objective led to the sell of efficient profit-making ones. In fact,

TABLE 11

Index of Industrial Production

Base 1980-81=100	
1981-82	109.3
1982-83	112.8
1983-84	120.4
1984-85	130.7
1985-86	142.1
1986-87	155.1
1987-88	166.4
1988-89	180.9
1989-90	196.4
1990-91	212.6
1991-92	213.9
1992-93	218.9
1993-94	232
1994-95	251.5
1995-96	283.7
1996-97	299.5
1997-98	319.2
1998-99	332.0

Source : Calculated from *Economic Survey* of various years.

the selling of shares of public sector units has become a regular feature since 1991 but the amount collected always fell short of the target. The idea of autonomy of the public enterprises, with just a Memorandum of Objective (MOU) with the government to list the mutual objectives also failed. On the top of a public enterprise is always a government official and given the hierarchical nature of Indian bureaucracy, the career prospects of the officer becomes more important than the efficient functioning of the organisation.

Secondly, the idea that the retreat of the public sector would be compensated by the vigorous entry of the private sector has not been realised. Both corporate savings and investment failed to raise the level of overall savings and investment. They remained much below the peak levels attended in the eighties. This is contrary to the predictions of the

World Bank. Actually, in less developed countries, the government activity in a particular sector enthuses the private sector. The massive curtailments in irrigation, power and other related agricultural and rural needs, to bridge the fiscal gap, have not been compensated by increased private investments. So, it has led to a fall in demand for industrial goods.

Thirdly, the modernised share market with the SEBI at its top, also failed to grow. The overall savings level did not increase; rather the growth of the share market was at the cost of banks, insurance companies, provident funds and other traditional sources of savings. A number of new glossy financial companies attracted savings from the common people, but they winded up their business within three to four years. The regulatory body was unable to control the irregularities and the massive share scam. So, the confidence of the middle-class investors was violently shaken. The marginal but crucial role of the Foreign Institutional Investors (6%) also alarmed the Indian dealers.

Fourthly, the role of the licensing system in the pre-reform years was not all negative. The original idea behind licensing was to channelise scarce capital resources in priority areas, decided by the government. In reality, it made way for the corrupt officials to amass illegal wealth through bribes. It would have been better to reorient the licensing system with changing needs rather than abandoning it altogether.

Fifthly, rather than short-term movements of foreign capital through the share market, Foreign Direct Investment would have a longer and deeper role in the industrial development of the future. While foreign loan is a liability for the country as a whole, FDI is the responsibility of the company alone. This has created a lack of confidence among the companies, even though they welcome it as a part of globalisation.

So, we may conclude that all these factors have led to an environment, which is not very conducive to the growth of an industrial sector led by private enterprise, which still functions with the objective of short-term profit motive.

Related to the growth of the industrial sector are the issues of labour market reform and labour standard. As we have seen, the export of Indian carpets was at stake as EC countries opposed the involvement of child labour. Here we can find out the double standard of the so-called trinity of Fund-Bank and WTO. Labour market reforms are advocated to invoke the full play of the market. But proclamation of labour standard requires active intervention of the national governments.

About labour market reforms, in most of the countries it cannot be undertaken because of strong internal opposition. India is no exception. However, the process has started with freezing of employment in the government and public sectors. It is accompanied by a cut in the organised

employment by means of voluntary retirement schemes (VRS). The growth in employment in private sector will not be able to take care of this problem, because they would generally go for capital-intensive production process. The common people have to fall back on the low productivity informal sector. This problem will be accentuated by the high mobility of capital across the borders with restricted labour mobility, as directed by the WTO. The 'local content requirement' of capital and labour, as insisted by the East Asian countries, in their early days of industrialisation, cannot be insisted upon again because of WTO agreements. Lifelong employment will become obsolete and 'contractual, flexi-time' labour would become the general norm. As multi-national companies would be able to pay abnormally high salaries to their top management staff, this would be going to distort the salary structure of the indigenous companies. Disparities within the company would also increase. So, eventually the labour market reforms would be anti-poor and the accompaniment of other restructurings like trimming of the public distribution system would enhance the miseries of the common masses.

The imposition of a uniform labour standard is coming from the WTO. It should be remembered that the only advantage the developing countries enjoy in the global trade is that of cheap labour. So the idea of labour standard has been prompted not by the plight of the exploited poor workers of the Third World, but from the fear of the competition of cheaper imports from those countries. So, if the WTO at the insistence of the rich countries, go for setting global rules to standardise labour market behaviour along with parity in wage and working conditions, then that would take away the main advantage of the Third World countries. This would also be economically absurd because the wage level of any country would have to be in tune of the general economic level of the country. This would also go against the rules set by another UN Agency, the International Labour Office. The ILO was for setting labour standard, but not neglecting the local situation. The ILO also took the view that social insurance and security were basic human rights. These two are conspicuously absent in the WTO agenda.

4. THE FISCAL QUESTION

The stabilisation agreement with IMF in 1991 had two basic points. The first was to control inflation and the second was to control the fiscal deficit. The fiscal deficit was as high as 8.33% in 1991.The government was able to control for a few years and then it again took an upward turn. It can be shown that years of low fiscal deficits were years of low growth. As the main policy was to curtail public expenditure, as we have seen in

case of the performance of the major sectors of the economy, the control of deficit was at the cost of growth. The economy was operating at a lower level.

It should be made clear at the outset that, the deficit at the level of the central government has always been a major issue of the Indian economy. The annual budget had deficit year after year. For the follower of the Keynesian tradition, this was thought something very natural. 'Deficit financing' was thought to be the remedy. The basic argument for deficit financing was that if the money generated for the purpose was fruitfully used for productive purposes, this would lead to higher production, inflation would be temporary and in the long run higher supply of goods would take care of inflation. Higher production would increase the demand for goods and services in the long run with increased income in the hands of the people. But the results would be opposite if the money is used to finance the deficits in the revenue accounts, unproductive expenditures like defence and increased salaries of the government sector. In India, most of the times, the second path was taken leading to many more ills of the economy. From 1991, rightly the emphasis was shifted on 'fiscal deficit' from 'budget deficit'. The advantage of 'fiscal deficit' over 'budget deficit' was in the treatment of borrowing. The latter did not bother how the deficit was covered; the borrowing may be internal or external. But, fiscal deficit takes into account borrowing. Let us have a look how the different deficits are measured.

Budget Deficit measures the difference between the total receipts and expenditure of the government. *Revenue Deficit* measures the excess of expenditure over the revenue receipts. Thus, any of these conventional measures does not take into account the nature of borrowing. But, *fiscal deficit* is the excess of total expenditure of the government, including loans, over revenue receipts and non-debt capital receipts. *Net fiscal deficit* is the difference between gross fiscal deficit and net lending. Another new concept is *primary deficit*. It is the difference between the gross fiscal deficit and the interest payments. It indicates the borrowing requirement of the government in the absence of debt service burden of past borrowings by the governments. Below Table 12 gives an idea about the movement of these deficits over the last decade.

So, we see that there has not been much success with fiscal management. For the last few years, the fiscal deficit is around 5% and the revenue deficit around 2%. As it is clear from Table 12, the primary deficit is showing a downward trend, as so is the net RBI credit. So, it would imply the increase in borrowing from other sources. The government, not very confident of its own ability to control the deficits, is planning to bring a fiscal management bill in the next Parliamentary

session. The bill proposes to bring down the revenue deficit one-half percent or more of the estimated GDP at the end of each financial year and to zero by the end of five financial years. The fiscal deficit would also reduce by the same rate and come down to 2% within five years. The only exception would be on the grounds of unforeseen circumstances like defence and natural calamity. Now, two points are to be remembered here. Firstly, it seems that the government is not averse to borrowing, the bill will not object to borrowing from privately owned and controlled capital market at the market rate of interest. Secondly, the international experience about a financial bill of this type is not very encouraging. The European Union was supposed to bring down the fiscal deficit below 3% of GDP. Most of the countries, especially of South Europe, found it difficult to reach this target. Japan introduced a legislation of such type in 1997, but shelved it within one year. The experiences of the developing countries are yet to be examined. The target set by India is even more stringent than the so-called developed countries. So, instead of going for reducing fiscal deficit by curtailing public expenditure and reducing low growth, it would be better for the government to find out new ways for increasing revenue.

TABLE 12

Measures of Deficit of Central Governments

(As percentage of GDP)

Year	Fiscal Deficit Gross	Fiscal Deficit Net	Primary Deficit Gross	Primary Deficit Net	Net RBI Credit	Revenue Deficit
1990-91	8.33	5.73	4.32	3.35	2.75	3.47
1991-92	5.89	3.99	1.58	1.45	0.89	2.64
1992-93	5.69	4.28	1.29	1.65	0.6	2.63
1993-94	7.01	5.35	2.74	2.83	0.03	3.81
1994-95	5.71	3.99	1.35	1.19	0.21	3.07
1995-96	5.1	3.59	0.86	0.91	1.68	2.52
1996-97	4.9	3.41	0.53	0.66	0.14	2.4
1997-98	5.87	4.16	1.54	1.5	0.85	3.06
1998-99	6.43	4.54	2.01	1.82	0.67	3.85
1999-00	5.59	4.93	0.9	1.99	-0.29	3.77
2000-01	5.1	4.16	1.49	1.5	0.64	3

1999-2000 : Revised Estimate

2000-01 : Budget Estimate

The GDP figures up to 1992-93 is with as1980-81 base year. after that the new series has 1993-94 base year.

Source : Calculated from Dasgupta and Dey, Table II.

5. CAPITAL ACCOUNT CONVERTIBILITY AND INTERNATIONAL TRADE

Capital account convertibility is thought to be the ultimate end of globalisation. There are some obvious advantages of capital account convertibility (CAC). Those are: the availability of a larger capital stock to supplement domestic resources leading to higher growth, reduction of the cost of capital stock and improved access to international financial markets. This allows the residents to hold internationally diversified portfolios, reducing the vulnerability of income streams and wealth of domestic real financial stocks, lowering funding costs for borrowers and increasing the prospects of higher savings. Allocative efficiency increases with dynamic gains of internationalisation, stimulating innovation and productivity. This also leads to rationalisation of the domestic tax structure, with a tendency towards international norms.

On the other hand, there are risks associated with CAC. As this is a relatively new phenomenon, its possible effects are yet to be studied. Generalisation on the basis of a few countries would dilute the whole issue. But, it can be said that any rush towards CAC without strengthening the basic economy would be foolish, as the possible consequences are so sudden and drastic, that the country may not be able to control the situation. So the timing of the CAC is very important. In fact, the Indian government is delaying this particular move and at the time of East Asian debacle, it praised itself for this particular strategy.

Historically, even the developed countries of the North had been slow to open up their capital accounts. Though the OECD decided on a code of liberalisation in 1961, the member countries were sceptical about it. Actually, after the oil crisis in the seventies, several countries including UK imposed restrictions on capital movement. Full currency convertibility became the norm in 1980s. Even in the nineties, some countries of South Europe maintained restrictions on outward movement of capital. For the developing countries, some of them liberalised their capital accounts as they had a healthy balance of payments. However, recently some of the developing countries rushed towards this move despite weak economic conditions. The experience of ten countries - Argentina, Indonesia, Malaysia, New Zealand, Chile, Korea, Mexico, Thailand, the Philippines and South Africa - has been used by the Indian experts to finalise the path of CAC. Hajra (2002) has made an excellent study of the benefits and disadvantages faced by these countries. Most of the countries initiated this move after some external crisis. Countries with strong economic fundamentals have benefited mostly as they could stabilise their external sector and maintain a high growth rate. But the countries, which undertook this

measure as a part of a broader package of reform without strengthening the domestic economy, have faced instability in the external sector and had to reimpose restrictions on capital account. So the timing and sequencing of CAC in a phased manner with broader financial sector reforms and macroeconomic policies seem to be very important. The above-mentioned study looked into the preparedness of the Indian economy for CAC, on the basis of nine indicators. Those are: gross fiscal deficits as percentage of GDP, inflation rate, movement of broad money, amount of NPA of scheduled commercial banks, real effective exchange rate, current account deficits, ratio of current account deficit to GDP, foreign exchange reserve and its composition.

As we have seen in the previous section, India has not been able to make much progress in reduction of fiscal deficit. Controlling fiscal deficit resulted in low growth of the economy. The country has achieved some success in controlling inflation. So, it has brought down the real lending rate. During the last five years, the prices of industrial goods have remained more or less stable, but not the prices of primary products. As the latter is the largest sector in the economy, this instability may become critical in this context. The movement of broad money was quite unstable during the period. Nevertheless it showed high growth rate compared to narrow money indicating a high growth of time deposits. The CRR was gradually reduced, but a variety of regulated interest rates stood in the way of the development of an integrated financial market. As for NPA, the ratio of incremental NPAs of scheduled commercial banks and all public sector banks, to their loan assets declined significantly from 14.4% in 1997-98 to 12.8% in 1999-00, and from 16 % to 14% respectively. The nominal exchange rate declined during the decade, whereas real exchange rate remained stable both by ten country and five country- weighted indices.

Current Account Deficits (CAD) are run in the balance of payments to overcome the domestic resource constraints. But if external debt increases, then high CAD would mean draining of resources for debt servicing. In 1991, the CAD was almost 3% of GDP and it triggered off the worst balance of payments crisis since independence. After that competent policies in the external sector led to remarkable improvements in most of the important indicators in this respect. Foreign Exchange Reserves showed remarkable improvements over the last decade, in terms of most of the indicators recommended by the Tarapore Committee on CAC. Even then, the setting of any time limit for CAC would be inappropriate, without strengthening the domestic economy.

6. NEW HORIZONS OF GROWTH

We have seen earlier that most of the indicators of the external sector have performed well in the recent years. Contrary to the predictions of World Bank, the surge in export has not come from the primary sector but from the most modern sector of information technology. The export of software have generated revenue of $6.2 billion in 2000-01, almost 22% of India's total export. This particular industry has created history in the Indian stock exchanges, apart from value-addition and employment generation. So, one may say that production and export of software may open up a new horizon of growth.

In tracing the growth of the software sector, it may be said at the outset that the data given by NASSCOM do not match with the official data. But as official data is not always available, often we have to depend on NASSCOM data.

TABLE 13
Growth of Indian Software Industry

(Rs. Crores)

Year	Domestic Market	Export	Growth rate of Software Exports
1996-97	2600	3700	
1997-98	3470	6500	75.68%
1998-99	4950	10940	68.31%
1999-00	7200	17150	56.76%
2000-01	9500	28500	66.18%

Source : Calculated from Dasgupta and Chakrabarti, Table 2.

This growth rate is quite spectacular. In terms of share of total exports, it has increased from 2.31% in 1995-96 to 22.01% in 2000-01. On the other hand, the hardware industry is shrinking continuously. It is also to be noted that despite the unprecedented growth of the IT sector, India is still a very small player in the international field. Even in 2000, India's revenue is only 1.65% of world revenue. Even within the software sector, India has negligible presence in the product-package sector, whereas it has recorded its importance in the professional and the service sector. One of the major spurts in the growth came in the Y2K period, where software professionals were required for codification. After this period, obviously the growth rate slowed down. At present the prospect lies in e-commerce and Euro-

conversion. As for the destinations of export, though Indian software went to 95 countries in 1999-2000, the main destinations are North America (62%) and Europe (24%). This indicator alone can show the actual nature of Indian software export. Both on-shore and off-shore exports are basically sub-contracts from North American and European firms. This is the main hindrance to the independent growth of the Indian software industry. India has the main requisites of software development (the most important being cheap skilled manpower with knowledge of English). But they are basically doing piecemeal jobs as ordered by foreign firms. Most of these jobs are low-level ones like codification. The foreign firms themselves usually do the high level jobs like system designing and system management. This absolute dependence makes the whole industry vulnerable to the ups and downs in the U.S. and European software industry.

7. CONCLUSION

The discussion in the five previous sections has clearly shown that after the initiation of the New Economic Policy, the economic environment of the country is not all that bright. As for the two main sectors, we may say that there is a *status quo* in the agricultural sector, i.e. though there has not been any remarkable change in the performance in terms of growth rate, production structure or composition or export performance, it has not failed the country in any respect. There is definitely scope for better performance in agricultural export. The composition and direction of growth can surely take a new turn. But the performance of the industrial sector is miserable by any measure. We have discussed in detail about the possible causes of such a downturn. So, it is high time that the policymakers should change their approach towards the industrial sector. Increasing demand for industrial products from the rural sector can only cure the severe demand deficiency the country is suffering from. The full implementation of the land reform programme becomes a necessary condition in this respect. The fiscal management of the country is far from satisfactory. In the present situation, the introduction of capital account convertibility would become disastrous, as it has happened in some Latin American and East Asian countries. Lastly, we looked into one of the emerging sectors of the economy, i.e. software exports. This sector has performed quite well in the recent years. But as we have seen, the performance of this sector entirely depended on the US software sector. So it is vulnerable to ups and downs there. It would be most irrational to think that the country can come out of the present depression just by backing on this single sector. One of the shortcomings of the paper is that

it has not looked into the service sector separately. Actually, if the productive sectors fare badly, the sudden spurt in the service sector cannot be sustained for a long time. Secondly, a look into the figures shows that the share of the service sector in the gross domestic product has remained almost constant in the last two decades. There has been sudden increase in growth rates in some of the components of the service sector, but there is no sign of sustained increase there. With the administered increase in the salaries and pays of some of the white-collared jobs like public administration, this growth rate in even more meaningless. So, the lesson from the last decade is obvious. With the similar experiences of the other countries, and of course of India herself, there should be a serious search for alternative paths of growth even within the diktats of the WTO, World Bank and IMF. Otherwise, the situation may become gloomier within a few years.

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EMERGING ECONOMIC ENVIRONMENT IN INDIA–SOME ISSUES

PABITRA GIRI

1. INTRODUCTION

What is economic environment? The word 'environment' means 'the aggregate of surrounding things, conditions, or influences' according to the Random House Dictionary of the English Language, while the meaning of the word 'economic' is 'pertaining to an economy', or, 'pertaining to the production, distribution, and use of income, wealth and commodities'. Therefore economic environment broadly refers to the surrounding conditions in which economic activities are carried out, rather than referring to only economic things, conditions or influences. The economic environment should be understood in the same way as we understand the term 'economic geography' (i.e., geography of economic activities) in contrast to the way we understand the term 'biological environment' or 'chemical environment'[1]. Sometimes connotation of a term follows from its use. For instance US Congressman Edward Royce early in the year 2000 said that 'India's economic environment was still not as "market friendly" as it should be'.[2] Chinese Government promised in January 2002 to 'create a more stable, transparent economic environment for domestic and overseas enterprises'.[3] In both the cases the term economic environment refers to environment for business activities.

It should be admitted that the focus on economic environment is a recent trend. Why does this accentuated concern for economic environment? This seems to be fallout of globalization process - that is, globalization of capital of the developed countries of West (or North). Along with the increased mobility of capital from one nation state to another, in the form of direct foreign investment and foreign financial investment, the issue of economic environment has gained importance overtime. The environment in which capital has to operate, that is to complete its circulation process M-C-C′-M′, to use a familiar Marxian terminology, or M-M′ (in case of finance capital) differs from one nation state to another quite substantially. The neo-liberal philosophy of the global capital preaches for uniform economic environment across the nation states.

Economic environment may be conceptualized and studied from various perspectives. As mentioned earlier, economic environment may be considered from the perspective of different economic agents like domestic and foreign or large and small entrepreneurs and their activities. Economic environment may not be same for all agents at point of time or across space. Again one may be concerned with the question of the suitability of the economic environment for attaining the broad social objective of economic growth and development. Whatever be the case there will be a 'macro' economic environment and a 'micro' economic environment. Another important point to remember is that economic variables having very close interrelation with government policies, institutional arrangements, the technological development, economic environment *should be* conceptualized and *is* conceptualized in term of a matrix of economic as well as non-economic variables. Thus in a complex interrelated system like economic system, economic environment has to be understood in terms of a set of core factors, which themselves may influenced by a large number of other factors - economic as well as non-economic. These core factors, influencing the capital accumulation process, defines the economic environment, which may vary across countries or within a country across regions, or within a country in different time spans.

2. ECONOMIC ENVIRONMENT–A CONCEPTUAL FRAME-WORK

Below we first examine the concept of macro and micro economic environment and then propose a set of five core factors characterizing economic environment.

Macro Economic Environment: may be perceived as those factors of economic environment that are common to all business agents - large and small. The macro economic environment of a country is characterized by four elements : (a) the structure and role of the market, (b) the nature of competition in the market, (c) uncertainty and risk, and (d) expectation about the economy. These are in turn determined by various other factors both internal and external to the nation state. The factors internal to the nation state include the government policies, the legal system, the nature of the government at different levels, social values and customs, technological change, property rights, etc. Those factors which are external to the nation state include (i) world situation, and extent of integration of the national economy with the global economy, (ii) international regulations, (iii) international prices of exhaustible resources. It may be noted here that these elements can not be completely separated from one another nor are they mutually exclusive.

Micro Economic Environment : To understand what is referred here as micro economic environment, we visualize, following Aoki *et al.* (1990), firms as "nexus of treaties" or a series of contracts. One of the important contracts is the labour contract. The transaction cost associated with the labour contract depends on the labour-management relation, the attitude of trade union and their political philosophy. Similarly the stability and costs associated with various other contracts like credit contracts, service contracts determine the day to day functioning of the firms. The components of economic environment related to the execution of the contracts by the firms may be referred as micro economic environment. This micro-economic environment is likely to vary from one region to another. The growth process across the regions tends to vary, as micro economic environment tends to differ from region to region.

In the light of the above discussion we propose a core set of five factors characterising economic environment, keeping in mind that the concept of environment entails relative autonomy from individual action, and hence a stability in short to medium run. The first four are related to macro economic environment: (a) market-orientation, (b) competition, (c) risk, and uncertainty (d) expectation. Fifth factor, namely, transaction cost is related to the micro economic environment. Each of these factors depends on a number of immediate causal variables, which in turn depend on a set of other factors. Further, the core five factors are related to a set of variables, which may be referred to as effect variables. Though we have suggested five core elements of economic environment, the actual indexing of economic environment may be based either on the basis of cause variables or on the basis of effect variables, or both.

Chart 1 illustrates the nature of interrelation between the core factors characterizing economic environment and various economic and non-economic factors influencing them. On panel A, there are five core elements of economic environment mentioned above. On panel B we show a set of economic factors are related to these core elements. These are effective demand, supply conditions including infrastructure provisions, openness of the economy, and technology. On panel C we place factors like government policy, world situation, legal and institutional arrangement, and political and social conditions, which influences factors characterizing economic environment either directly or indirectly through the economic variables given on panel B. Obviously the listing of factors in each panel is only indicative but not exhaustive.

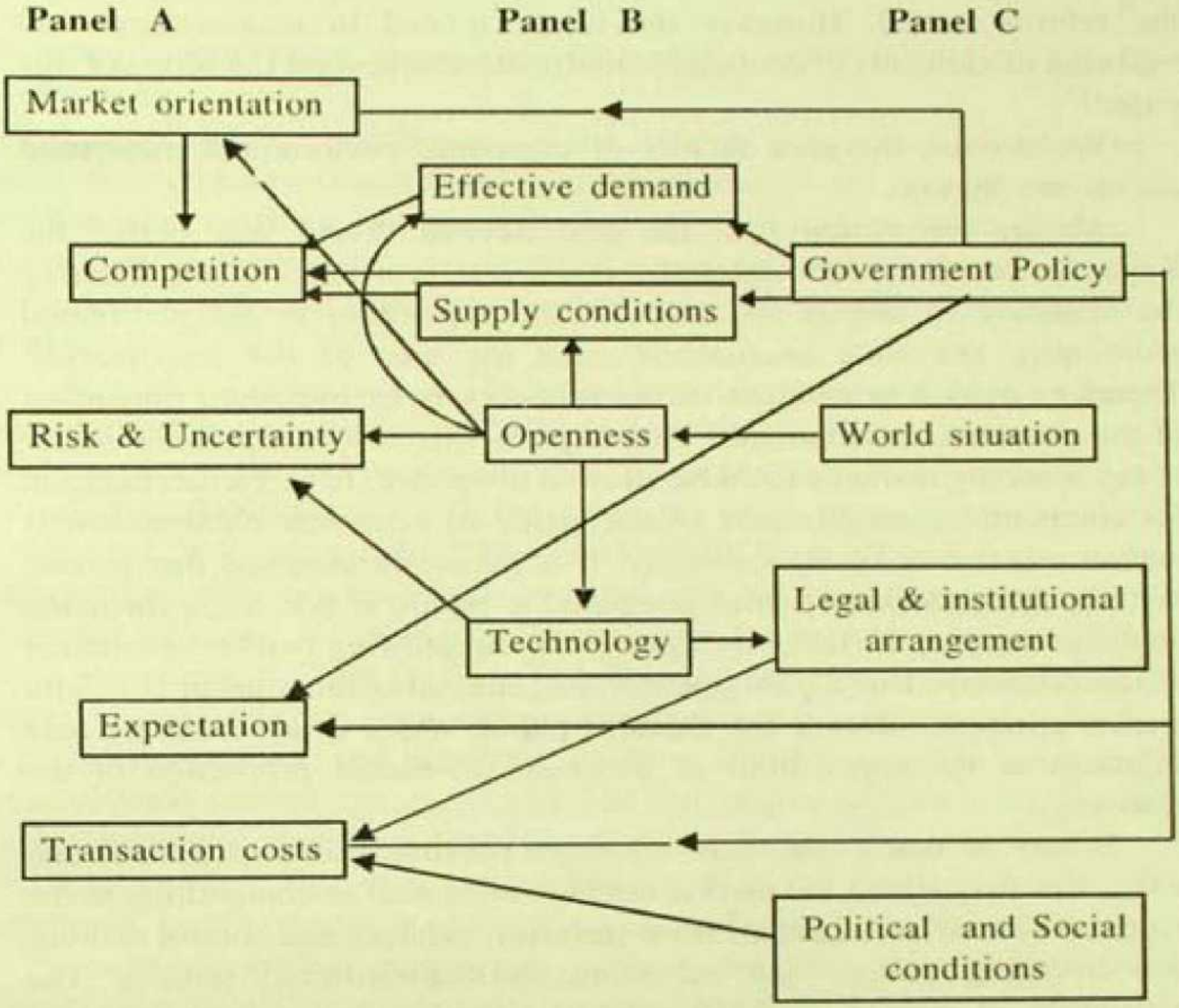

Chart 1
Inter-relation between economic and non-economic factors related to economic environment.

From Chart 1 it can be observed that the market-orientation depends on the government policy as well as on the world situation. While government policy directly influences market-orientation, world situation influences the same through openness of the economy. Competition depends on a host of factors including effective demand, supply conditions etc., which in turn depends on government policy, world situation. The main point is, as illustrated in the Chart 1, the complex nature of interaction among variables and factors influencing economic environment.

It is important to find out appropriate measures of factors and also the interrelations among the factors. This is necessary because otherwise one cannot really assess the extent of change in economic environment in a certain direction. For example we cannot say how market friendly economic environment has been, or how transparent the situation is since

the reform started. However the issues related to measurement and indexing of elements of economic environment is beyond the scope of this paper.

We discuss the core factors of economic environment mentioned above one by one.

Market orientation : In the post Second World War period the Keynesian welfare state assumed a major role in managing and directing the economy in almost all nation states. According to the neo-liberal philosophy, the state encroached upon the area of the free market. Therefore market orientation of the economy is an important dimension of the economic environment. This requires that in every possible sector of the economy market should be allowed to operate. In fact a precondition for competition, another core characteristic of economic environment is market orientation of the economy. It is generally assumed that private sector is more market oriented compared to public sector. So, a shrinking public sector may be taken as a proxy for the growing market orientation of the economy. But a public sector unit may also function in line with market principles. Hence the share of public sector in an economy may be taken as the upper limit of non-market-oriented proportion of the economy.

It may be noted that there are other possible forms of government action that may lessen the market orientation as well as competition in the economy. These include apart from various regulatory and control actions, like licencing policy, and subsidies and administered pricing. The percentage of subsidy to GDP may be taken as one measure of state intervention in the market economy.

Competition: It is a two edged sword under capitalism. Absence of competition leads to inefficiency, and lack of innovation and productivity growth, while too much competition leads to over-investment and excess capacity (Perelman, 1999, p.102). In other words competition is a desirable element of economic environment but only up to a certain degree. This leads to the question: how to ascertain the level of competition in an economy and, whether it is in the desirable range or not? Second, the nature and scope of competition is also important, and competition faced by different types of entrepreneurs may not be the same. For example with the entry of the multinationals in the Indian market, certainly the domestic firms are facing great competition.

The level of competition depends on the number of firms, their size and size of the market. Thus given the size of the market increase in number of firms increases the level of competition. And given the number of firms an increasing size of the market reduces competition. Therefore, the expansionary fiscal policy of the Keynesian welfare state reduces the level

of competition by providing an expanding market, which in long run breeds inefficiency.

In contrast, the opening up of the national economy facilitates the entry of foreign firms including the multinationals in the domestic market and therefore increases the level of competition. It may be noted here that the nature of competition also changes: it may come out to be an unequal competition leading to monopolistic or oligopolistic control in the domestic market.

Risk and Uncertainty : The other important element of economic environment is uncertainty and risk. In economic literature distinction is made between risk and uncertainty. Uncertainties that can be measured in terms of probabilities are risk but there are other types of uncertainty, which are not measurable. The uncertainty arises from incomplete information: this incompleteness may be over time and across space. In a period of quick technological change, the future becomes uncertain, because one usually does not have complete information about the possible changes with certainty. Similarly, information across space will be vast in a globalized market, and therefore, likely to be less complete compared to a national market. Increased risk and uncertainty will be reflected in higher insurance premium, high discount rate for the future.

Expectation : Expectation regarding future is an important element of economic environment as it influences investment in the economy. Investment determines aggregate demand and also the supply side. Expectation formation is a complex process. The past trend of the economy and faith in the institutions plays an important role in expectation formation, but the key element is what Keynes called 'animal spirit' of investors. Further, expectation formation is guided by herd behaviour.[4] Expectation of general households regarding future is also important as it influences the consumption and saving decisions in the economy.

Transaction costs : Every economic activity consisted of a collection of transactions, through market as well as through contract. The costs of carrying out these transactions (distinct from the value of goods and services transacted) are referred to as transaction costs. Transaction costs are related to various types of contracts, including labour contracts, credit contracts and services obtained from government. The transaction costs include not only direct monetary payments but also loss of time, energy and various non-monetary resources. Transaction costs arise from imperfect flow of information and lack of transparency. Two other factors contributing to increased transaction costs are corruption and rent-seeking activities (Roy, 1996).

3. CHANGING CONTOURS OF INDIA'S ECONOMIC ENVIRONMENT

In this section we shall discuss how the economic environment in India has changed or is going to change in the post-economic reform period. It has to be kept in mind that economic reform is a gradual process and the adjustment is not instantaneous. For the various measures there may be varying time lags before the potential impacts on economic environment are realized. Further, in real life the *ceteris paribus* (other things remains equal) assumption rarely holds, and hence it would not be proper to attribute all changes since 1990 to economic reform. There are other forces including the legacy of the past still lingering - because an economy is like a river, various streams (influences in course of time) fall in it, and it has its own interactive dynamics as it flows on.

A glimpse of the past

In India during the pre-reform period, both market orientation and competition were limited. Firstly, the presence of public sector in many of areas of the economy limited the areas of market operation and competition. Secondly, even in the areas where private sector was allowed to play, the licencing policy and various other regulatory measures limited the competition and full operation of market forces. Control over exports and imports, through quota and tariff restrictions, eliminated the competition from outside. Thus private sector units in most cases enjoyed a captive market, without much competition. Moreover, an expanding domestic economy under the expansionary fiscal policy dampened the spirit of competition among the firms. The absence of competition led to inefficiency and slowed the process of technological of change and updating.

Risk and uncertainty arise in a changing situation: change may be in nature, in the level of competition, there may be fluctuations in market or change in technology. The Indian situation as described above, was not much open to change in different fronts and as a result risk and uncertainties were minimized. The two understandable sources of uncertainties were the year-to-year fluctuation in agricultural production due to variations in monsoons, and changes in the fiscal policy of the government. The public sector firms - both manufacturing and financial - functioned with the assumption that that government would come to rescue in case of emergency.

The expectation in the pre-reform period was guided primarily by compensatory fiscal policy. This happened because in the import substituting industrialization regime government expenditure was the main

source of autonomous expenditure, and the fluctuation in the effective demand, if any, was compensated by the government expenditure.

Coming to the transaction costs, it can be stated that in the pre-reform period transaction cost was quite substantial. Like transportation cost, transaction cost is a deadweight cost in the sense it does not add to welfare. The lower the transaction cost the better is the economic environment. Part of the transaction cost is associated with the corruption in the bureaucracy, part is due to rent-seeking activities of the political power brokers, and part is due to the imperfect information flow.

Changes and underlying forces

Certainly there is difference between the economic environment of pre-reform and post-reform period. Doing away with the licensing system and gradual opening up of the economy has certainly increased the market orientation and competition in the Indian economy. The change in the government policy with respect to foreign direct investment and foreign institutional investment, the modification of the legal and institutional arrangements e.g. with respect to stock market, the banking system, etc. have helped matters.

As a result of liberalization the risk and uncertainty element has increased at least for the domestic entrepreneurs. Part of this is due to the fact that now the domain, from where a change may originate is large due to global integration. Secondly the gradual elimination of control and regulation would mean that things tend to be more volatile. A third factor which raises uncertainty as well as risk element is the rise of finance capital across the world. In fact risk and uncertainty would increase further once capital account convertibility of rupee is introduced.

About expectation it can be said that, right now expectation for the future growth and improvement is very much low. This is partly due to the change in the fiscal policy of the government and prevailing world stagnation. The stringent fiscal policy of the Indian government slows down the expansion of internal effective demand, while the prospect of export oriented growth appears to be weak due to world stagnation as well as barriers in the developed north against the exports from the south.

That transaction costs are going to come down for the following reasons. Firstly because various governments have to compete for the capital and therefore they are forced to change there style of functioning. Administration has to be geared up and freed from red-tapism as quickly as possible. Secondly capital has to survive now a days through the exploitation of not only economies of scale but also economies of scope and speed. To attain these economies of speed the state is bound to reform itself and reduce the rent-seeking activities at various stages. The rent

seeking activities are not consistent with transparency requirement and therefore obstruct, among other things, realisation of economies of speed. However it is difficult to say whether corruption is reduced as there is no one to one correspondence between reduced transaction cost and reduction of corruption, because only a subset of corruption is associated with the transaction costs.

4. CONCLUSION

The concluding section raises two issues relevant for research on economic environment. The issues are interrelated. One is the policy issue related to economic environment. Unless policy intervention is possible to change economic environment or policies can be formulated to effectively cope with such changes, study of economic environment would have little significance. The second related issue is indexing and measurement of economic environment. For formulating and adjusting policies there is need for monitoring economic environment. That would be possible only if we find out suitable measurement of the core elements of the economic environment and related database. Then only one can study the changes in economic environment and act accordingly.

NOTES

1. In this sense economic environment should mean economic dimensions of environment.
2. See CII News Letter, 23rd March, 2000.
3. People's Daily Online - http://english.peopledaily.com.en/200201/26/
4. See 'Expectation' in International Encyclopedia of the Social Sciences, vol. 4.

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INDIAN PUBLIC ENTERPRISES IN THE EMERGING ECONOMIC ENVIRONMENT

DIPTI KUMAR CHAKRAVORTY

1. INTRODUCTION

Public Enterprises (PEs) in India have been at the 'commanding height' of the economy since the 1950s. The number of PEs and investment therein have increased by leaps and bounds during the last forty-five years, and it is felt that whether the Indian economy would either sink or swim would depend upon the efficiency with which these enterprises operate (Narain, 1988). Public Enterprises now occupy near about 80% of the total paid up capital of the corporate sector, and it is mainly through the efforts of PEs that the country has become self-sufficient in the production of many of the basic and infrastructural goods like coal, steel, power, petroleum, fertiliser, etc. But it is also true that, in many respects, the PEs have failed to work upto expectation. Specially in the matter of economic viability, the role of PEs was so dismal that they increasingly became a subject of public debate and criticism. In the Seventh Plan, therefore, it was stressed, for the first time, that the emphasis should be on consolidation, improvement and modernisation rather than on indiscriminate expansion of capacity except when it is imperative. Since then there has been a hue and cry over the issue and, ultimately, we have got twin effects of a new economic environment along with the new Industrial Policy of 1991.

The new Industrial Policy that was announced on July 24, 1991, has brought in a radical change in the economic environment of our country. As a result of the Policy, there has been a complete abolition of Industrial licensing except for items of health, strategic and security consideration. The Resolution of 1956 had reserved 17 industries for public sector, but now only three industries are reserved exclusively for public sector. The presumption that can be made therefrom is that the PEs have, as if, failed to meet the challenges they were provided and, therefore, no longer they can be trusted with increasing responsibilities. On the other hand, the private sector enterprises are viewed now as the saviour of Indian economy and that is why we have resorted to so many d's like deregulation, delicensing, dereservation, disinvestment and so on. In view of this, it has been pertinent now to analyse once again how far the PEs have really failed

to achieve the objectives set for them. For this purpose, we shall outline at the outset (Section 2) the salient features of PE objectives. and then we shall give some highlights on achievement of those objectives by PEs in Section 3. The position of PEs in post-reform era is briefly discussed in Section 4. This is followed by an overview of the present craze for privatisation in Section 5. The last Section contains the concluding remarks. For the sake of volume, the study, however, will be limited to the performance of Central PEs only.

2. A GLANCE ON PEs' OBJECTIVES

The first Industrial Policy Resolution (IPR) of India after independence was adopted in 1948. Since then we have been observing that the *basic objectives* of PEs are two-fold, viz.,

(a) acceleration of economic growth, and

(b) ensuring social justice.

Later on, the Constitution of India was adopted in 1950 "enjoining the State to promote the welfare of the people by securing a social order in which social, economic and political justice will prevail". In 1954, the decision for the "Socialistic Pattern of Society" was taken giving the social factor more prominence than any other thing. As a result, the next IPR that was adopted in 1956 was found to stress more on 'social justice', i.e., on reduction of disparities in income and wealth, removal of regional disparities in setting up industries, prevention of private monopolies and the like (Jaiswal, 1971). In the years 1977 and 1980, two other Industrial Policy Statements were adopted in India. But they only envisaged comparatively greater role for PEs, bringing no notable change in the objectives of PEs set in 1956 (Chakravorty, 1994).

The oft-quoted *objectives* of PEs are summarised (PEs Survey, 1999-2000) below :

(1) To ensure the rapid economic growth and industrialization of the country and create necessary infrastructure for economic development,

(2) To earn a return on investment and thus generate resources for development,

(3) To promote redistribution of income and wealth,

(4) To create employment opportunities,

(5) To promote balanced regional development,

(6) To assist the development of small scale and ancilliary industries,

(7) To promote import substitution, save and earn foreign exchange for the economy.

From the list it appears that a plethora of objectives were imposed from the very beginning on the shoulder of PEs. There was, again, no

clarity as to the objectives of individual PEs, and hence, while some public sector managements attempt till date to present profit as index of their efficiency, most of them actually try to make virtue in spite of absence of profit. In the Industrial Policy of 1991, the focus has no doubt been on PE profitability; however, the social objectives of PEs have not been fully shrugged off. Structural reform in PEs and the provision of autonomy for their efficient management are intended to be the core points of new Industrial Policy. But the objectives of PEs have not received so much importance there. Moreover, the policymakers now are perhaps in a dilemma, and hence the PE objectives, instead of being clear, have been further obscured. Some of the recent measures promote this confusion. For example, it is wanted, on the one hand, the improvement in the performance of PEs, but, simultaneously, they are selling off the profit-making PEs. There is categorical assertion that the interest of employees will be protected but in practice there is downsizing of PE workforce to the detriment of workers. Reduction of economic disparity is still today one of the vowed objectives of our country. Nevertheless, the new Industrial Policy is found to render a hearty welcome to the private gaints in almost every sphere of economic activity. As a result, the PEs in India are still to work in the dilemma of public versus private interest. Let us see in the next section how Indian PEs are actually working under this peculiar situation.

3. PEs PERFORMANCE—SOME HIGHLIGHTS

The report of the Public Enterprises Survey for the year 1999-2000 reveals that the PEs in India still occupy the key position in Indian economy. Growth of total investment in central PEs is a clear indicator of this view (Table 1). Investment in PEs was only Rs. 29 crore in the

TABLE 1

Growth of Investment

Particulars	No. of PEs	Investment (Rs. in Crores)
At the commencement of-		
1st Plan	5	29
2nd Plan	21	81
3rd Plan	47	948
4th Plan	84	3897
5th Plan	122	6237
6th Plan	179	18150
7th Plan	215	42673
8th Plan	246	135445
9th Plan	242	213610
As on 31.3.2000	240	252554

Source : PE Survey, 1999-2000, Vol. 1.

First Five Year Plan, and this has taken a gigantic figure of Rs. 252554 crore as on 31.3.2000. Thus, it appears that the PEs are working yet as a corner stone of Indian economy. A period of ten years has elapsed since we have opened the door for private enterprises. Nevertheless, as it appears from Table 2, the share of PEs in total industrial production of our country

TABLE 2

Contribution of PEs to total Industrial Production

Product	%age in total Production	
	1988-89	1999-00
Coal	98	97
Lignite	100	100
Petroleum	100	87
Basic Metal	57	34
Alluminium	48	50
Lead	100	79
Zinc	80	83
Nitrozen	46	32
Phosphatic	31	23

Source : PE Survey, 1999-2000, Vol. 1

is as overwhelming today as it was in the pre-reform era. So far as the social objectives like creation of employment opportunities, conservation of energy for sustainable development, upliftment of backward classes and regions are concerned, the role of PEs in no way can be compared with their counterparts in the private sector. A cursory look at Table 3 will give

TABLE 3

Achievement of Social Objectives

Share of Backward Region in PE Employment	43%
Share of Backward Classes in PE Employment	27%
Share of Backward Region in PE Investment	36%
Social Overhead to Net Profit	23%

Source : PE Survey, 1999-2000, Vol. 1. Results computed.

a clear idea as to the achievement of social objectives by PEs. Share of rural people and weaker communities in PE workforce (43% and 27% respectively) holds the argument that only PEs can ensure the balanced economic growth. Investment of 36% of PE capital in backward regions

is also a pointer to that trend. Expenditure to the tune of 23% of net profit under the head 'net social overhead' measures clearly the degree at which the PEs are committed to public purpose and social responsibility. Employment generation and provision of fair deal to labour are other two important milestones of economic development, particularly in a labour-surplus developing economy like ours. In these areas also, as is exhibited in Table 4, the role of PEs can never be gainsaid. During 1990s, the size of PE workforce has shown a downward trend due to implementation of voluntary retirement schemes. Nevertheless, near about two million people are now working only under central PEs. And, their average annual per capita emoluments, as shown in the Table, indicate that the public sector is not only the biggest employer but also a model employer that recognises its responsibility towards welfare of employees. This is because of backward regions/classes, provision of public utility services, selling it is said that PEs in India are "instrumental in matters like development

TABLE 4
Employment and Average Annual Emolument

Year	No. of employees (lakhs)	Per capital emolument (Rs.)
1991-92	21.79	56508
1992-93	21.59	64983
1993-94	20.70	72043
1994-95	20.62	82517
1995-96	20.52	106876
1996-97	20.08	110662
1997-98	19.59	129987
1998-99	19.00	147482
1999-2k	18.54	176727

Source : PE Survey, 1999-2000, Vol. 1.

basic inputs at administered prices, providing medical, educational and such many other facilities for their employees" (Chakravorty, 1989). Usually, we do not give due weightage to all these factors while evaluating the performance of PEs, though we know that these social objectives eat up a lion's share of PE revenues.

In spite of satisfying so many social needs, the PEs have been able to enhance their profitability year after year (Table 5). Profit before interest and taxes (PBIT) to capital employed in PEs was only 4% in 1970s, but now it has gone up to 14%. Improvement in their financial performance has been impressive after liberalisation. The PBDIT to capital employed,

another accepted measure of PE profitability, is also at a satisfactory level of 20.60%. Internal resource generation, we know, is another important

TABLE 5
Profitability Profile

Year	PBIT to Capital Employed (%)	PBDIT to Capital Employed (%)
1971-72	4.06	9.60
1976-77	9.29	13.48
1981-82	12.10	18.29
1999-2k	14.00	20.60

Source : PEs Survey of years concerned.

measure of financial performance. And from Table 6 it appears that, in this area also, the performance of PEs is commendable. During the last twenty years the amount of internal resource generated in PEs has gone up by leaps and bounds. Since 1990 the additional investment in PEs is almost nil. Taking into consideration that factor, the growth of internal resource generation since then appears more creditable.

TABLE 6
Internal Resource Generation

Year	No. of units generating resources	Total amount of resource generated (Rs. in crores)
1979-80	113	1030
1983-84	116	3282
1993-94	136	16676
1996-97	144	25554
1999-2k	134	35891

Source : PE Surveys of different years.

The profitability figures, as shown so far, cannot be termed, again, as the real profitability of PEs. This is because the tools that have been used for the measurement of such profitability are more applicable to private sector enterprises than to the peculiar characteristics of PEs. In case of private enterprises the main focus is on shareholders, and hence, the traditional tools of profitability measurement reflect only the net residue available to the shareholders, instead of the wealth as a whole created by the firm. In case of PEs, on the other hand, that total wealth is of greater importance, as the major part of the values produced in PEs is realised by

other segments of society, leaving a very small fraction of total revenue as net profit. In view of this, we depict in Table 7 the volume of value addition by PEs in relation to their capital employed and turnover. What stems up therefrom is that the performance of PEs in India is not so dismal as is alleged every now and then.

TABLE 7

Value Addition by PEs

(Rs. in crores)

Particulars	1998-99	1999-00
Value Added (VA)	113328	123856
Capital Employed (CE)	265093	303451
Turnover (TO)	310179	389310
VA to CE (%)	43	41
VA to TO (%)	31	32

Source : PEs Survey, 1999-2k, Results computed.

The above-mentioned picture does not necessarily suggest that we should be complacent with the performance of PEs. Several earlier analyses of PE performance in India and abroad have also revealed that the PEs have performed far below an acceptable economic return. Performance of loss-making PEs, in particular, is truly disappointing. Approximately, 50% of our PEs are running at a loss year after year, and the magnitude of their yearly loss is continuously showing an increasing trend (Table 8). The

TABLE 8

Loss-making PEs and the magnitude of yearly losses

Year	No. of Loss-making PEs	Yearly Loss (Rs. in crores)
1991-92	102	3723
1992-93	106	4113
1993-94	116	5223
1994-95	109	4883
1995-96	102	5188
1996-97	104	5939
1997-98	100	6667
1998-99	107	9305
1999-2k	106	10060

Source : PEs Survey, 1999-2000, Vol. 1.

profitability profile of PEs, as shown in Table 5, exhibits the net result after deducting the losses of such loss-making units. The profitability of profit-making PEs, from that viewpoint, is much higher than the reported overall profitability. For example, in 1999-2000 the overall net profit of PEs was Rs. 14,555 crore, and this was arrived at after adjusting the loss of loss-making units amounting to Rs. 10,060 crore. Thus, the overall profit figure of PEs would have been enhanced by as much as 69%, had the loss-making units been made to work at least at break-even point. In view of this, it may be said that the performance of profit-making PEs of our country is more or less upto the mark. The revival of sick PEs, in that sense, should be the prime objective of the newly introduced industrial policy. In the next section, we examine this issue in brief.

4. POSITION OF PEs IN POST-REFORM ERA

In spite of the aforesaid performance, the PEs are unable to hold the key position as they did earlier. It was expected that the reform work will aim at the revival of sick units, and as a result, the position of PEs in Indian economy will develop further. But in practice we see a different picture. It is true that 67 sick PEs have been brought, upto date, under the purview of the Board of Industrial and Financial Reconstruction (BIFR) with a view to finding out the ways for their revival or rehabilitation. But the BIFR has taken final decision only on 14 PEs as on 31.3.2000 (Table 9). This decision, again, has gone mostly against the PEs, as in nine out of fourteen cases the BIFR has suggested 'winding up', and only two out of 67 sick PEs have been declared so far as 'no longer sick'. Among pending cases, there are other six units to whom 'winding up' notices have been issued. Thus, it may be said that the fate of sick PEs in post-reform period is not at all bright. What is more astonishing is that the position of profit-making PEs, which have been named for their excellence as 'Navaratnas' or 'Miniratnas', as the case may be, is also being downsized gradually day by day. Among 106 profit-making PEs, only two have been labelled as 'poor performers in MOU (Memorandum of Understanding) rating. Of the rest, 48 have been ranked as 'excellent', 28 as 'very good', 9 as 'good' and 17 as 'fair performers'. Nevertheless, we see that the Department of Disinvestment (DoD) is regularly submitting proposals for disinvestment of PEs, and the Cabinet Committee of Disinvestment (CCD) is giving nod to them. From this, it may be presumed that the main rationale behind the so–called reform is, as if, to raise only the non-inflationary form of finance (Misra & Puri, 2001), and with a view to getting such fund, the government is now in such haste that almost in all cases the PE equity is being sold for a fraction of what it could actually fetch (Kothari, 1994). What is

TABLE 9

Status of Central PEs registered with BIFR as on 31st March, 2000

Particulars	Nos.	Nos.
I. Final decisions taken		
Winding up Recommended	9	
Dismissed	2	
Dropped	1	
No longer sick	2	14
II. Cases pending		
Revival Scheme Sanctioned	20	
Draft Scheme Circulated	7	
Winding up Notice Issued	6	
Under Enquiry	15	
Failed	3	
Stay Order	2	53
Total cases registered		67

Source : Public Enterprises Survey, Vol. 1, 1999-2000.

revealed from the above is that the post-reform era is not a sunny day for PEs. The profit-making PEs are being sold out and the loss-making ones are being forced to wind up. A very small number of PEs are, therefore, expected to survive, but they also will have to be reoriented in the line of private enterprises. So, in short, it may be said that the post-reform era means the age of privatisation. To what extent this is justified is examined in the next section.

5. CRAZE FOR PRIVATISATION—A CRITIQUE

From the preceding Section it appears that there is a massive wave of privatisation in our country at present. This wave was raised particularly in 1980s out of the belief that the government operations were neither efficient nor effective as were warranted. Recently, that wave has been magnified by the globalisation of production and service operations that has put a great pressure on government–run entities to compete effectively in the global market (Enthoven, 2000). For this, now, almost all the countries in the world have adopted the process of privatisation, though the forms of privatisation vary from country to country. The most prevalent forms as to this are denationalisation, deregulation, trade sale and contracting out of operations and services. However, in India, the major

plank of the privatisation programme has been the disinvestment of government equity in a select number of PEs.

The arguments that are given in favour of privatisation, over and above the aforesaid one of efficiency, are usually as under (Gupta, 2002).

- Releasing huge amounts of scarce public resources locked up in non-strategic PEs for deployment in areas which are much higher in social priority.
- Reducing public debt of unmanageable proportions.
- Transferring the commercial risks as related to investment in PEs to the private sector.
- Creating beneficial impact on the capital market.
- Bringing relief to the consumers by way of ending public sector monopoly, leading to more choices, and cheaper and better quality products and services.

The arguments as such in favour of privatisation may have some theoretical support. But in practice they are not so sound. Sengupta (1997) has shown algebraically that the raising of funds through disinvestment may cut back the non-tax revenues of the government; and if the public equities are issued to foreign investors, the external balance may be negatively affected frustrating the objective of reducing foreign debt. We are trying to reduce the public sector monopoly. But, the experience of Andhra Pradesh, one of the provinces of Indian Republic, has proved once again that the private monopoly is more harmful than public sector monopoly. There has been allegation of rampant corruption in the private power sector and the unprecedented tariff hike in 2000 is still vivid in public memory (Theodore, 2002). The private sector efficiency, on which we are betting now emphatically, is not also beyond question. Using total factor productivity model, Dholakia (1980) has shown that the index of total factor productivity (i.e. overall efficiency) in PEs increased by 33% over the period of study, whereas in private sector that was only 10%. The study as such may have the limitations of subjectivity that lies in quantifying the qualitative factors. But this is undoubtedly an eye-opener on this issue.

The public sector is often criticised for the magnitude of sickness in it. But Table 10 exhibits clearly that the sickness in private sector is no less acute in India. We blame the public sector for its sub-optimal managerial efficiency. But a study of the Reserve Bank of India showed that in 75% cases the most common reasons for sickness in private sector were the mismanagement, faulty planning and operational bottlenecks (Banerjee, 1987). What is more interesting is that the number of sick units in private sector has gone up at a faster rate in the post-reform period,

whereas that of the loss-making PEs, as shown in Table 8, has not increased at all. Besides, it is known to all that 40% of our loss-making PEs were originally the sick units of private sector. So, the private sector in no way can be viewed as the panacea. Moreover, it is a fact that private sector is always reluctant to invest in low-yielding infrastructural projects. A recent study known as Global Entrepreneurship Monitor, conducted by

TABLE 10

Magnitude of Industrial Sickness in Private Sector

Year	No. of Sick Units		
	Large & Medium	Small	Total
1980	1401	23049	24550
1992	2427	233441	235868
1996	2374	262376	264750
1999	2792	307289	310081

Source : Tata Services Ltd., Statistical Outline of India, 2000-01.

London Business School, has revealed that in India only 15% entrepreneurs are interested in manufacturing ventures, whereas 56% prefer trading in consumer goods. Thus, there is enough reason to apprehend that India in near future will be fully dependent on foreign manufacturing if the leadership of our economy is left in the hands of private owners. Above all, there is the question of allocative efficiency. In a country like ours where near about half of the people are still below the poverty line, this allocative efficiency is of prime importance. But from the experience of Bangladesh, which carried out one of the largest privatisation programmes between 1975 and 1990, it may be pointed out that the allocative efficiency there has been affected largely by privatisation (Basu, 1993). This is because the private owners work basically with profit motive. Lower the allocation of business income under the heads wages, salaries, etc. greater will be the possibility of satisfying that profit motive. Out of this belief, the private owners tend to give very low wages, and hence, we see that the industrial workers in the public sector earn 15 to 80 per cent more than the wages earned by workers in the private sector in our country (Table 11). Again, this wage differential between the public and private sector is the highest (80%) in Andhra Pradesh which was supposed to show the path to the rest of the nation in the field of privatisation.

Thus, it may be said that the craze for privatisation that we notice now in our country is mostly without any logical and economic justification. The ownership change as such has very little to do in having the desired

TABLE 11

Wage Differential between Public and Private Sector

Names of the States	Wages Differential (%)
Andhra Pradesh	80
Gujrat	66
West Bengal	46.5
Uttar Pradesh	45
Haryana	36
Maharastra	15.9

Source : Annual Survey of Industries, 1999-2000, *The Statesman*, May 22, 2002.

result. It may rather worsen the situation, aggravating the problem of distribution of income and wealth. Some of such evils of privatisation have already started to surface, and it is not unlikely that very soon we shall have to combat a large number of similar evils.

6. CONCLUSION

It is crystal clear that the private sector does not have that kind of public purpose or social responsibility as we need in a developing country like ours. Still, we are running after disinvestment and privatisation, possibly to exploit the advantage of professionalism. But we know that "the degree of professionalisation of managers in the public sector has always been quite high if one goes by their qualifications and background" (Chattopadhyay, 1985). In this context, JRD Tata once observed :

> "From my long personal experience of public sector management, I am convinced that a prime cause of the inefficiency and high cost prevailing in most public sector enterprises in our country does not lie in the quality, competition or dedication of their management and staff, but in the continued denial to them of the degree of managerial freedom of action essential to the efficient management of any large undertaking" (Sarker and Das, 1990).

So, even at this late hour of the day, it is perhaps not impossible to bring public enterprises back on the rail. Privatisation may give us only higher productivity, whereas the PEs, if somehow brought back on the rail, can serve both the purposes, i.e., acceleration of economic growth and realisation of social objectives. We know that in PEs there is huge unutilised capacity. That means the scope for improvement is very much there in PEs. We need not expend any amount for capacity expansion. By increasing the level of capacity utilisation with a moderate dose of

modernisation where necessary we may enhance PE profitability. The workers who are treated now as 'excess' and are given compulsory or voluntary retirement can be provided with productive jobs. The purchasing power of the working class will be enhanced thereby, which is practically a precondition for all-round development of our economy. Reversely, if we, in the name of so-called reform, facilitate concentration of economic power in the hands of some private giants, the produced goods will go on piling up and there will be none to purchase them. The steel industry of our country is an example in this context. Both the private and public enterprises of this industry are working now very efficiently. Still, they are running now through a crisis only due to a slump in demand. In view of all these, it may be said that balanced economic development cannot be achieved through largescale privatisation. So, the policy-makers should have a thorough review as to the suitability of the new Industrial Policy in the Indian economic environment. Any hasty decision on such major issue is unwarranted for the overall long-term benefits the economy is likely to enjoy through the operation of a sizeable public sector.

It should be widely recognised that even after a full decade of liberalisation, the private sector has failed to make the requisite break through in infrastructure and basic services, so vital for the economy. The power sector exemplifies that the private sector has remained far away from the ambitious targets it had opted for. Of course, progress has been made in information technology and in consumer industries like automobiles, soft drinks and cosmetics; but in a considerable portion of these sectors domestic private enterprises have been displaced by multinationals. It is certain that the public sector would continue to play a vital role for quite some time in the Indian economy.

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ROLE OF FOREIGN DIRECT INVESTMENT IN THE INDIAN ECONOMY

JITA BHATTACHARYYA

India is the seventh largest and second most populous country in the world. India's economic reforms started in the year 1991 when she was facing an acute balance of payments crisis. Now, India has completed a little more than a decade of economic reforms. This decade has brought about much greater changes in the Indian economic environment than the preceding four decades after independence. During this period of economic reforms the financial sector has been liberalised, trade has become more open and tax procedures have become more simplified and consequently her fiscal deficits have been reduced and the external accounts have become stronger. However, there is much left to be done. A vast multitude of the people is still below the poverty line. While the percentage of households below the poverty line was 32.4% in 1993-94, it declined to 23.4% in 1999-2000, a decline at the rate of only 1.5% per annum. This rate is even lower than the rate of population growth of 2.14% as per the 1991 Census. The per capita income is also considerably low even if India is compared with that of China, whose per capita income of $2,000 a year is more than twice that of India[1]. The fiscal deficit is still high. Public sector deficits are also quite high and appear to be unsustainable in the long run.

It has been observed that the investments by the private sector have been, by and large, much more productive than those of the public sector and the operation of market forces is forcing the less productive firms to weed out. While trade has been liberalised, the agricultural sector, which forms a vital part of the Indian economy, has remained almost untouched by the economic reforms. The process of economic reforms still remains unfinished. The growth rate of the GDP, which increased from 4.8% in 1997-98 to 6.6% in 1998-99, came down to 6.40% in 1999-2000 and to 6.04% in 200-2001. The Gross Domestic Investments that reached a peak of 25% in 1997-98 dipped to 23% in 1998-99 and to 22.5% in 2000-2001. If the country is to achieve a higher rate of growth then its economic institutions and policies must undergo major changes. During his Independence Day speech in the year 2001, the Indian Prime Minister announced that the government has set itself a target of doubling India's per capita income by 2010. To achieve this, India must achieve a much higher

rate of growth than hereto before (say 8% or 9%) during the next ten years.

The Draft Approach Paper to the 10th Five Year Plan also asked the Planning Commission to go ahead with the preparation of the Plan on the basis of 8% growth rate. There is the need to make the 10th Plan more realistic by chalking out implementation strategies at various levels.

These should combine both macro and sectoral approaches. The growth target of 8% will need an investment rate of 32% of GDP and domestic savings of at least 30% of GDP[2]. For this purpose, the present efforts are not enough. The Planning Commission Chairman has outlined 14 areas requiring urgent action. At the top of the list is 'shore up the weak finances of the centre and the states by pruning unproductive expenses and non-merit subsidies'. He was of the view that downsizing in government cannot be delayed any more and rejuvenation of the power sector and labour reforms is must. He also emphasized *inter alia* on measures to increase FDI[3]

To bridge the gap in the flow of funds in the public sector, increased participation of the private sector is necessary. For developing countries, foreign capital can be an effective source of capital[4] funds. Apart from grants and aids, it may involve participation by foreigners in either of the two forms, viz. (i) direct investment, and (ii) portfolio investment. Foreign investments during 1991-92 to 2001-2002 are shown in table 1.

TABLE 1

Foreign Investments (US $ million)

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02 (Apr.-Nov.)
A. Direct Investment	129	315	586	1,314	2,133	2,696	3,557	2,462	2,155	2,339	2,365
B. Portfolio Investment :	4	224	3,567	3,824	2,748	3,312	1,828	-61	3,026	2,760	1,315
(a) FIIs	–	1	1,665	–	–	1,926	979	-390	2,135	1,847	799
(b) ADR/GDR	–	240	1,520	–	–	1,366	645	270	768	831	477
(c) Off shore funds & share	4	3	382	–	–	20	204	59	123	82	39
Total (A+B)	133	559	4,153	5,138	4,881	6,008	5,385	2,401	5,181	5,099	3,680

Source : Up to 1996-97, *Reserve Bank of India*

1997-98 to 2001-02, *Business Standard section, The Statesman* (27-02-02) [Kolkata edn.]

It is apparent that total foreign investments and portfolio investments peaked at \$6,008m and \$3,312m respectively in 1996-97, while FDI peaked at \$3,557m in 1997-98. Thereafter, the total foreign investments dipped. However, while the fall in FDI was not substantial, a considerable decline (negative in 1998-99, representing net outflow) in portfolio investment is perceptible, although the figure dwindled over the next few years. The decline in portfolio investment is mainly attributable to the contagion from the East Asian Crisis, which adversely affected capital flows to all the emerging markets. FDI inflows subsequently increased. The International Finance Corporation's recent estimate is that India's actual FDI inflow is close to \$ 8 bn. If this is true, FDI would contribute 1.7 per cent of India's gross domestic product, which is just a fraction lower than the 2.0 per cent share it has in China[5]

Of the two sources of foreign capital, this paper, however, focuses on the role of FDI in the Indian economy. The discussions that follow are divided into the four sections mentioned below:

1. Importance of FDI in a developing country like India
2. India's FDI Policy and actual inflow during the pre-and post-economic reforms periods
3. Whether conditions in India are conducive to inflow of FDI
4. Problems associated with FDI and possible remedies

1. IMPORTANCE OF FDI IN A DEVELOPING COUNTRY LIKE INDIA

FDI is considered to have a major role in stimulating economic growth in developing countries as it has the ability to deal with two major problems of these countries – (i) shortage of financial resources, and (ii) shortage of technology and skill. It is that source of finance which is accompanied by real capital and technology developed in the country from which the fund comes. Consequently, it has become a critical issue for the policy-makers in the developing countries.

From the early 1970s, net flows of FDI to developing countries varied considerably but have risen rapidly since 1986. FDI inflows to developing countries are estimated to have gone up from US \$130bn in 1996 to US \$149bn in 1997. India's share of global FDI flows increased from 1.8% in 1996 to 2.2% in 1997. On the other hand, India's share in net portfolio investment flows to the developing countries declined to 5.1% in 1997 after increasing to 8.7% in 1996. Total foreign investment in India declined from US \$6,008m in 1996-97 to US \$5,385m in 1997-98. In the year 1998-99, there was a sharp decline in the level of total foreign investment to US \$2,401m due to a net outflow in portfolio investment as a result of the

contagion from the East Asian Crisis. The foreign investment increased thereafter mainly due to inflow of FDI.

2. INDIA'S FDI POLICY AND ACTUAL INFLOW DURING THE PRE-AND POST-ECONOMIC REFORMS PERIODS

Prior to the New Economic Policy, the Government of India had invited foreign capital only on a selective basis. Foreign capital was welcomed only in areas where upgradation of technology was necessary, in industries in which further growth and development was required and sophisticated technology was needed, and where sustained growth of exports was required. The government published a list of industries where foreign collaboration was not permitted. In the remaining industries, foreign collaboration was permitted according to the merit of the case. The Foreign Exchange Regulation Act (FERA), 1973, generally restricted foreign equity to 40% of equity capital. Industries, requiring sophisticated technology but catering mainly to the domestic market, were permitted foreign equity up to 74%. In the case of export-based industries, foreign equity could however, go up to 100%.

Foreign investment under the New Economic Policy

The Government of India enunciated the new Industrial Policy as a part of the liberalisation process of the Indian economy initiated in July, 1991. This new Industrial Policy, whose three basic pillars are liberalisation, privatisation and globalisation, has several provisions which may lead to greater inflow of FDI in India. The main provisions are stated below.

1. Foreign equity participation in high priority industries can be up to 51%. 34 broad areas covered include transportation, food processing, metallurgy, fertiliser, chemicals and industrial equipment. FDI in these sectors will be freely permitted.
2. FDI is now permitted in trading companies which are primarily engaged in export activity, and hotels and other tourism-related industries.
3. FDI in areas other than those mentioned in 1 and 2 above will also be allowed on a case-to-case basis.
4. Companies with 51% foreign equity participation will be granted automatic relaxation from restrictive provisions of the Foreign Exchange Management Act (FEMA), 1999[6].
5. A Foreign Investment Promotion Board (FIPB) has been set up to promote the flow of FDI in India.
6. Import of capital goods will be freely allowed if payment is covered through foreign equity.

7. Companies with foreign equity up to 51% will be encouraged to act as export/ trading houses and will be treated at par with domestic trading houses.
8. Foreign equity proposals need not necessarily be accompanied by foreign technology agreements.
9. Automatic permission for foreign technology agreements in high priority sectors will be given for a lump sum payment of Rs. 1 crore, 5% royalty for domestic sales and 8% for exports subject to a total payment of 8% of sales over a 10-year period from the date of agreement or for 7 years from the commencement of production.
10. The condition of dividend balancing on foreign investment has been scrapped with effect from June, 2000.

Another important development in this connection is that the on March 13, 1992, India signed the Convention of the Multilateral Investment Guarantee Agency (MIGA), a World Bank affiliate that provides insurance to foreign investors against political risks. This is expected to facilitate the flow of FDI to India as foreign investors can now take insurance cover for nationalisation and related risks.

In British India, important industries like coal mining, tea plantation and the railways were developed with British capital. After Independence, the role of foreign capital was drastically reduced by nationalisation and other control measures. With the liberalization of the Indian economy, the large Indian market is again being opened up to foreign investors. Several companies are setting up or have already set up operations in India. There are several strategies by which foreign enterprises can operate in India. The entry strategies in case of FDI may be of two major types.

1. A foreign investor may directly set up its operations in India through a branch office or a representative office or a liaison office or a project office of the foreign company.
   (i) A foreign company can set up a liaison office in India to test the Indian market. It can enter with much greater investment later if it is convinced about the potential of the Indian market. A liaison office is, however, not allowed to undertake any business activity in India and cannot, therefore, earn any income in India. The role of such offices is, therefore, limited to collecting information about possible market opportunities and providing information about the company and its products to the prospective Indian customers. The opening and operation of such offices is regulated by the law relating to foreign exchange in India. Approval

from the Reserve Bank of India (RBI) is required for opening such offices.

(ii) Foreign companies planning to execute specific projects in India can set up temporary project/ site offices in India for that purpose. Specific approval from the RBI is necessary for setting up a project office. Such approval is normally given in respect of government approved projects. The RBI can give approval for setting up project offices even for executing private sector projects. Such approvals are specific to the particular project to be executed and last only till the completion of the project.

(iii) The Government of India has allowed foreign companies engaged in manufacturing and trading activities abroad to set up branch offices in India for the purposes stated below.

a) To represent the parent company/ other foreign companies in various matters in India, e.g., to act as buying/ selling agents in India

b) To conduct research work in the area in which the parent company is engaged provided the results of the research work are made available to the Indian companies

c) To undertake export and import trading activities

d) To promote possible technical and financial collaborations between Indian companies and overseas companies.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to sub-contract these to an Indian manufacturer. Permission for setting up branch offices is granted by the RBI on a case-to-case basis. The RBI generally considers the operating history of the applicant company worldwide and its proposed activities in India for granting the approval.

2. A foreign investor may seek entry through an Indian arm. The strategies for entry through an Indian entity are mentioned below.

- A foreign company can commence operations in India through the incorporation of a company under the provisions of the Companies Act, 1956, in which its holding can be up to 100% depending on the business plan of the foreign investor, prevailing investment policies of the government and receipt of requisite approvals. Once a company has been duly registered and incorporated as an Indian company, it will be subject to the same Indian laws and regulations as applicable to other domestic Indian companies.

- Foreign companies can also set up their operations in India by forging strategic alliances with Indian partners. Setting up of operations through a joint venture may entail the following advantages for a foreign investor:
  - i) established distribution/marketing set up of the Indian partners;
  - ii) available financial resources of the Indian partners;
  - iii) established contacts of the Indian partners, which help to smoothen the process of setting up of operations.
- The other investment option open to foreign investors is the setting up of a wholly-owned subsidiary. This implies that the foreign company can own 100% shares of the Indian company. All such cases are subject to prior approval from the FIPB, which considers cases on a flexible basis and grants permission for 100% ownership on the basis of the following criteria:
  - i) where only 'holding' operation is involved and all subsequent/ downstream investments to be carried out would require prior approval of the government;
  - ii) where proprietary technology is sought to be protected or sophisticated technology is proposed to be brought in;
  - iii) where at least 50% of production is to be exported;
  - iv) in case of proposals for consultancy; and
  - v) in case of proposals for power, roads, ports and industrial model towns/ industrial parks or estates.

Foreign investments are approved through two routes, viz.,

1. Automatic route

The RBI accords automatic approval within a period of two weeks (provided certain parameters are met) to all proposals involving:

- Foreign equity up to 50% in 3 categories relating to mining activities (*List 2*)
- Foreign equity up to 51% in 48 specified industries (*List 3*)
- Foreign equity up to 74% in 9 categories (*List 4*)
- Where *List 4* also includes *List 3* items, 74% participation shall apply.

The lists are comprehensive and cover most industries of interest to foreign companies. Investments in high-priority industries or in trading

companies (primarily engaged in exporting) are given almost automatic approval by the RBI.

2. Government approval

Where, in the case of the specified industries the proposed foreign equity exceeds 50% or 51% or 74%, as the case may be, or if the industry is not in the specified list, specific prior approval is required from the FIPB.

The Government of India has been relaxing regulations affecting FDI over the years. On February 1, 2000, it was decided to make FDI automatic in case of all except a few areas[7]. FDI approvals through the *automatic route* increased to 25% during April- September 2001 as against 16% in the same period of the previous year.

The government has decided to allow 100% FDI in drugs and pharmaceuticals, airports, hotels and tourism. According to the experts, the reasons which compelled the government to invite enhanced foreign equity in pharmaceuticals are the necessity to avail of highly restricted technologies available in the west European countries to produce the fourth generation drugs and pharmaceuticals, and the need to invest substantial amounts in research and development which could not be put in by most Indian companies.

In the banking sector, the government has allowed 49% FDI in the case of private sector banks but in the case of public sector banks the cap of 20% still continues.

The defence industry sector has been opened up to 100% for the Indian private sector participation but FDI is permissible only up to 26%, subject to licensing in both the cases.

FDI up to 100% is permitted for development of integrated townships, including housing, commercial premises, hotels, resorts, city and regional level urban infrastructure facilities such as roads and bridges, mass rapid transport systems and manufacture of building materials.

The government is, at present, against allowing FDI in the retail sector.

FDI up to 100% is permitted in courier services subject to existing laws, excluding activities relating to distribution of letters for which prior government approval is necessary.

Table 2 shows the flow of FDI during 1980 to 1999 and during 1991-92 to 2001-02.

TABLE 2
Trends in FDI flows to India (US $m)

Year	Amount	Year	Amount
1980	87.0	1991-92	129
1981	12.6	1992-93	315
1982	66.5	1993-94	586
1983	61.3	1994-95	1,314
1984	99.5	1995-96	2,133
1985	103.0	1996-97	2,696
1986	85.0	1997-98	3,557
1987	83.0	1998-99	2,462
1988	173.0	1999-00	2,155
1989	252.0	2000-01	2,339
1990	236.0	2001-02 (Apr.-Nov.)	2,365
1991	155.0	**Total**	**20,051**
1992	233.0	Source : Up to 1996-97, *Reserve Bank of India* 1997-98 to 2001-02, *Business Standard section, The Statesman* (27-02-02) [Kolkata edn.]	
1993	574.0		
1994	958.0		
1995	2,100.0		
1996	2,600.0		
1997	3,350.0		
1998	2,260.0		
1999	2,200.0		

Source : Up to 1995, *PHD Chamber of Commerce*
1996 and thereafter, *World Investment Report*

An important feature of the FDI inflow is the huge gap between approvals and actual inflows. Whereas the total approvals between 1991and March 2000 amounted to $60.73bn, actual inflows during the same period amounted to $20.19bn, i.e., only 33% of the approved amount. However, the ratio of FDI inflows to approvals went up to 58.2% in 2000[8] as against 43.29% in 1998. One important point to note is that whenever non-resident Indians (NRIs) are involved, the percentage of actual inflow to approvals is much higher. This is explained by the fact that while their share of total approval between 1991 and 1997 was only 4.08% of total approvals, their share of total inflow of FDI during the same period was 22.09%.

Table 3 shows the approvals and actual inflows during 1991 to 1998.

TABLE 3

FDI Flow to India – Approvals versus Actual Inflows

Year	Approval (US $m)	Actual Inflow (US $m)	Approval (Rs. crores)	Actual Inflow (Rs. crores)	Inflow as % of Approval (in Re. terms)
1991	325	155	534	351	65.73
1992	1,781	233	3,888	675	17.36
1993	3,559	574	8,859	1,787	20.17
1994	4,332	958	14,187	3,289	23.18
1995	11,245	2,100	32,072	6,820	21.26
1996	11,142	2,383	36,147	10,389	28.74
1997	15,752	3,330	54,891	16,425	29.92
1998	6,975	2,230	30,814	13,340	43.29
1999	55,111	11,963	28,367	16,868	59.46
2000	NA	NA	37,089	19,342	52.15
2001 (Jan-Oct)	NA	NA	23,266	16,127	69.93

Source : Economic Survey 2000-2002

Note : The approval and actual inflows figures include NRI direct investments approved by the RBI.

If the trend witnessed in the first three quarters (January to September) of 2000 is any indication, FDI inflow into the country is likely to cross the $5bn mark in 2001 for the first time since the beginning of economic liberalisation notwithstanding global slowdown and political upheavals throughout the world including the US. FDI increased 46.71% in rupee terms at Rs.16, 306.47 crores ($3.62bn) during January to September 2001, as compared to Rs. 11,114.93 crores ($2.47bn) registered during the corresponding period of 2000. However, cumulative FDI approvals amounting to Rs. 22,588.43 crores ($5.02) were granted during the first nine months of 2001, which was Rs. 5, 673.41 ($1.55bn) or 20.07% lower compared to the approvals granted during the corresponding period of the previous year.

Country-wise flow of FDI to India

There has been a steady annual increase in the total amount of FDI approved over the last decade. The US tops the list of countries investing in India since 1991 and accounts for 26% of the total foreign investments. The UK ranks second accounting for 6.65% of the total investments. Other

major sources are Japan, Italy and Germany. However, the most notable feature is that South Korea increased its investment from a meagre amount of US \$6.3m in 1996-97 to US \$333.1m in 1997-98, but the FDI flows again declined to US \$85.3m in 1998-99.

More recent figures indicate that total FDI inflow since 1991 has been \$27.32bn (Rs.105,593 crores) and approval figures suggest that, till September 2001, the UK was the largest FDI investor in the country contributing Rs. 4,859.9 crores while the US proposed to bring in Rs. 3,874.3 crores and the Netherlands proposed to bring in Rs. 2,484 crores. The Mauritius route was being used to pump in FDI worth Rs. 2,301.6 crores[9].

Table 4 shows the country-wise flow of FDI into India.

TABLE 4

Country-wise flow of FDI into India (in \$m)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Mauritius		196.7	507.3	864.4	900.4	590.0
USA	98.8	202.8	194.6	241.0	687.4	452.8
Japan	36.9	95.0	60.9	96.7	163.5	235.1
Italy			11.3	27.7	42.9	115.6
Germany	35.1	34.6	99.7	166.2	151.4	113.5
South Korea		12.0	23.9	6.3	333.1	85.3
Netherlands	46.5	44.6	49.8	123.7	158.8	53.3
Others	185.7	286.3	470.5	549.0	518.4	354.4
Total	403.0	872.0	1,418.0	2,057.0	2,956.0	2,000.0

Source : Reserve Bank of India

The industry/service sectors with investment opportunities are power, telecommunications, electronics, software, education and training, food processing, mining, roads, ports, water, hydro carbons, healthcare and medical.

India recently emerged as the third largest low-income country recipient of FDI. Incentives initiated in 1991 and the subsequent more 'open door' policies have brought a cumulative FDI flow of US \$2.9bn during 1991-95 compared with a total of US \$1.0bn during the previous two decades, most of it going into infrastructure (particularly power and telecommunications) and petroleum refining, petrochemicals and automobiles in the manufacturing sector.

Table 5 shows the sector-wise break up of FDI and technical collaboration approved during the period August 1991 to January 1999.

TABLE 5

Sector-wise break up of FDI and Technical Collaboration Approved (August 1991-January 1999)

Sector	Share in percentage
Fuels	32.11
Telecommunications	17.83
Transport	6.85
Service	6.32
Metallurgical	6.00
Electrical Equipment	5.14
Food Processing	4.49
Hotel and Tourism	1.89
Others	19.27

Source: *Finance@IndiaMART*

Sector-wise classification reveals that investments in telecommunications, power and service sectors account for 20.3%, 15.65%, and 6.77% respectively of the total amount approved. Total investments in consumer goods sectors account for almost 30% of total approvals.

Sector-wise break-up shown in table 6 for the period 1993-94 to1998-99 shows that the engineering industry received the largest share of total FDI although in 1997-98 it yielded place to electronics and electrical equipment. Chemicals and services are also important recipients of FDI.

TABLE 6

Industry-wise flow of FDI into India (US $m)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Engineering	32.9	131.6	251.9	730.2	579.9	427.6
Chemicals	71.7	141.2	126.7	303.8	257.3	375.5
Services	20.2	93.4	100.4	15.2	321.3	368.5
Electronic & Electric Equipment	57.1	56.4	129.6	153.6	644.6	228.3
Finance	42.2	97.7	270.0	217.0	147.9	184.8
Computers	7.6	10.2	52.1	58.7	139.2	106.2
Pharmaceuticals	49.5	10.1	54.8	47.6	33.8	28.4
Others	121.8	331.4	432.5	530.9	832.0	280.7
Total	403.0	872.0	1,418	2,057.0	2,956.0	2,000.0

Source : Reserve Bank of India

3. Whether conditions in India are conducive to inflow of FDI

The important determinants of FDI flow are labour costs, quality of labour, infrastructure, incentives to investment including tax rates, government policy, market factors and foreign exchange rates.

Sasaki (1994) has pointed out two conditions for FDI.

Kindleberger's Condition – foreign capital must have a competitive advantage against local capital.

Lenin's Condition – the host country must have the quality and quantity of labour and a developed infrastructure in order to operate with foreign capital.

The following paragraphs examine whether, in the light of these determinants, conditions in India are conducive to the inflow of FDI.

Cost and Quality of Labour

A comparatively low wage rate is an important factor in attracting FDI to developing countries particularly the low-income countries. However, labour market rigidities and relatively high wages in the formal sector in India have been found to obstruct substantial FDI inflows, particularly into the export sector.

The quality of labour is a representative variable of the labour coefficient and has been found to be a determining factor in attracting FDI because it reflects on technology. The quality of labour very much determines whether technologies developed in the developed economies can be effectively used in the developing host countries like India. Low labour cost alone cannot attract FDI unless the desirable 'quality' of labour is available in the host country. The 'quality' of labour is not easily quantifiable. However, the level of both technical and non-technical education and labour productivity in the host country are considered as useful indicators. India's position in terms of skilled manpower is comparable with the best available in the world *vis-a- vis* the present scenario of global competition.

Market Size

Studies have indicated that there is a well-established correlation between FDI and the size of the market and some important characteristics like income levels and growth rate of a country. The size of the market may be approximated by the size of the GDP. However, India, in spite of its large market, has not been able to attract large FDI flows. Some experts point out that the size of the market in India is an indication of potentially high levels of FDI flows in the future. Others point out that certain other constraints are still restraining the flow of FDI to this country.

Government Policies

Surveys have revealed that liberal government policies encourage inflow of FDI. 'Open' economies attract more foreign investment. The relative size of the export sector is an indicator of openness. Research conducted by Singh and Jun (1995) indicate that exports, particularly manufacturing exports, are an important indicator of FDI inflows. Incidentally, over the past few decades, export growth in India has been much faster than GDP growth. Indian exports have recorded a growth rate of 18.18% and touched a 12-month high figure of $4.25bn in January 2002 as compared to $3.6bn in January 2001. This record performance in January 2002 has resulted in exports of $36.53bn during April 2001 to January 2002 as against $35.96bn in the same period in the previous year[10].

Privatisation in India has attracted FDI inflows from foreign investors. But, divestment of state assets is a highly political issue. It has met with strong resistance from the organised labour force as it is a threat to the existing jobs and the rights of the workers. The privatisation process is, therefore, neither very simple nor always desirable.

Political Risk

The impact of political risk on FDI inflows is not very clear. India has a stable democratic set up. There is no fundamental conflict between its political and economic institutions. It has an open society with strong collective and individual rights and an environment supportive of free economic enterprise. But, the democratic set up has proved to be more problematic than constructi•e. Moreover, systematic corruption, activities of the disruptive forces, poor work culture, etc., may prove to be important factors obstructing substantial foreign investment.

Infrastructure

Infrastructure includes roads, ports, railways and telecommunication systems, institutional development (e.g., accounting, legal services, etc.) and other dimensions. The location of FDI in China was largely governed by transport facilities and proximity to major ports. Poor infrastructure is often considered a major constraint for majority of the low-income countries. However, if the host government permits foreign participation in infrastructure, then poor infrastructure may also attract FDI. In India, although telecommunications and airlines have become attractive to foreign investors for FDI inflows, other more basic infrastructure, like road-building, have so far failed to attract FDI due to political risks and low returns.

Incentives and Operating Conditions

Specific incentives such as lower taxes have often been found to have no perceptible impact on FDI. However, evidence shows that removing restrictions and providing good operating conditions have generally had a positive effect. In recent years, the Indian government has relaxed most of the regulations regarding FDI. This has resulted in increased FDI flows during the last few years. However, bureaucratic delays, red tape and the lack of transparency in investment approval procedures are still de-motivating foreign investors.

Foreign Exchange Rates

The fall in the value of the Indian rupee has been found to be facilitating inflow of FDI.

4. PROBLEMS ASSOCIATED WITH FDI AND POSSIBLE REMEDIES

One of the major stumbling blocks in FDI is the conversion ratio, i.e., the ratio of converting proposals into actual investment. India has a low conversion ratio, which is primarily attributable to bureaucratic hurdles. The recent episode of the Enron's Dabhol power project highlights the structural inadequacies to a large extent. India's failure to attract FDI flows is directly attributable to the unattractive trade and openness policies of the government, lack of transparency in business and legal systems, excessive bureaucratic controls and inadequate infrastructural facilities. However, according to the 'FDI Survey 2002'[11], conducted by the Federation of Indian Chambers of Commerce & Industry (FICCI), there has been marked improvement from the last year (i.e., 2001) in policy implementation. 93 % of the respondents (as compared to 61% in the last year) observed that handling of approvals at the Centre was good to average. But, the survey revealed that state-level handling of approvals still needs improvement with 38% of the foreign investors ranking it poor.

The policy relating to labour followed in India is often seen as problematic from the foreign investors' point of view. Labour is not considered so much disciplined and productive and firing is not so easy especially if compared with that of China[12]

Another problem is that in India policies keep changing. Though policy-related parameters have improved as compared to the last year, the survey conducted by the FICCI shows that growth conditions have deteriorated and affected the sentiment of investors. The image of India as a favourable destination has also suffered primarily due to slower growth conditions, terrorist activities and ground-level hassles.

The main area of concern is the regulatory framework. About 52% of the investors involved in the survey felt this to be an impediment to growth.

Infrastructure facilities are still considered to be weak and an impediment to the growth of FDI.

Keeping in mind the hindering factors, the steps suggested below may be taken to improve the inflow of FDI.

1. Modification of property laws and investment regulations to provide attractive returns on investment
2. Liberalisation of rules relating to equity participation by foreign companies
3. Avoiding change in FDI policies too often
4. Increasing areas for automatic approval
5. Curtailing the role of the FIPB except in matters of great importance, e.g., the security of the country
6. Decentralisation of implementation to the state level, leaving the Centre to focus on policy issues and the broad legal framework
7. Focusing on the removal of ground-level obstacles, infrastructural bottlenecks, particularly in the power and transport sectors
8. Rationalisation of taxation laws and labour laws
9. Reduction of fees and taxes
10. Setting up Special Economic zones (SEZs)[13] to encourage flow of FDI
11. Expanding export processing zones (EPZs) to provide modern infrastructure for export-oriented projects
12. Increasing transparency in business and legal systems
13. Removing corruption, red tape and excessive bureaucratic controls
14. Setting up of a council comprising senior Central and State government officials and representatives of large foreign companies to review issues impeding inflow of FDI and take appropriate steps

While measures should be initiated to increase the flow of FDI to India, it should not be considered as the panacea for all the ills pervading the Indian economy. Rather, FDI is like that monster which, unless made to work properly, can devour its own master. Use of FDI in the Indian economy has been criticised by experts mainly on the grounds stated below.

- FDI in India has so far come mostly in the form of speculative investments and can leave on flimsy grounds, thus bringing about instability in Indian financial markets.

- Due to liberal FDI policies, many MNCs have entered in a big way in some highly-profitable areas where some Indian organisations were functioning well.
- Functioning and necessity of FDI in the power sector and telecommunications sector has generated considerable controversies as it may be unwise to allow foreigners to operate in those strategic sectors.

Thus, FDI cannot be considered as an unmixed blessing in the Indian economy. Following the Chinese model, greater NRI participation may be encouraged. The government has already initiated certain policy measures in that direction. Full convertibility of the NRI accounts, announced in the Union Budget for 2002-2003, is expected to increase the foreign exchange reserves by over 10bn in a year. The opportunity for NRIs to repatriate all their incomes at the time of necessity will encourage them to invest more. That apart, the higher rate of interest in India will motivate them to invest in India in a normal situation[14]

The Government of India has already expressed its intention to start 'visiting board rooms' of MNCs to impress them in a big way about the investment potential in India following the "East Asian countries' strategy" [15]

END NOTES

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2. Review of Planning Needs New Mindset, *Chartered Financial Analyst*, September, 2001, p. 36
3. Mid Term Review of the Economy, *The Chartered Accountant*, September, 2001, p. 277
4. Nevin, Capital Funds in Under-developed Countries (1961), Macmillan, London
5. *Financial Express* (13-7-2002) [Kolkata edn.]
6. FEMA, 1999, came into effect on June 1, 2000, replacing the FERA, 1973
7. (i) arms and ammunition,(ii) atomic energy, (iii) railway transport, (iv) coal and lignite, (v) mining of iron, manganese, chrome, gypsum, sulphur, gold, diamonds, copper, zinc, etc. Source : *Finance@IndiaMART*
8. Business Standard section, *The Statesman* (19-4-2002) [Kolkata edn.]
9. Business Standard section, *The Statesman* (9-1-2002) [Kolkata edn.].
10. Business Standard section, *The Statesman* (28 -2-2002) [Kolkata edn.].
11. Business Standard section, *The Statesman* (19-4-2002) [Kolkata edn.].
12. Chinese Reforms – Lessons for India, *Chartered Financial Analyst*, January, 2002, p. 31.
13. The Andhra Pradesh government has announced a special economic zone (SEZ) policy which envisages a single-window clearance of investors, exemption for small-scale and InfoTech industries from registration, 50% tax exemption on

stamp duty and registration fee on transfer of land for industrial use and full exemption from sales tax, VAT, luxury tax and state duties on transactions within the SEZ. – *Business Standard section, The Statesman* (19-4-2002) [Kolkata edn.]. The Maharashtra government has also announced an SEZ policy.

The Centre is also in the process of finalizing a piece of legislation for the SEZs intended to provide a single window clearance for these zones. The Centre will allow power trading in the SEZs. The RBI is expected to issue a notification to allow overseas banking units (OBUs) to operate in SEZs by 15th May – *Business & Finance section, The Statesman* (21-4-2002) [Kolkata edn.].

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CORPORATE FINANCIAL REPORTING IN THE NEW ECONOMY : ISSUES AND CHALLENGES

SWAGATA SEN

INTRODUCTION

The twenty-first century opens up new challenges for the financial reporting as the economic environment of present-day is distinctly different from the earlier times. The rapid growth of the new technology, globalisation of the business, revolutionary changes in the field of the communication and information technology, the domination of intellectual capital over the physical capital, the change in the mind set of the people at large are some of the factors which call for that a fresh look is to be taken at the existing financial reporting system and efforts should be made to make financial reporting more relevant and useful to the present-day users of financial statement. This paper makes an attempt to throw some light on these issues and has been sectionalised under the following heads:

A. Features of the New Economy
B. The nature of challenges the financial reporting faces in the new economy
C. Notable international works and efforts to combat these challenges
D. How financial reporting should cope with such challenges
E. Indian response to these challenges
F. Concluding observations

A. FEATURES OF THE NEW ECONOMY

New Economy has been described in the *Encyclopedia for New Economy* in the following way :

"When we talk about the new economy, we're talking about a world in which people work with their brains instead of their hands. A world in which communications technology creates global competition — not just for running shoes and laptop computers, but also for bank loans and other services that can't be packed into a crate and shipped. A world in which innovation is more important than mass production. A world in which investment buys new concepts or the means to create them, rather than new machines. A world in which rapid change is a constant. A world at least

as different from what came before it as the industrial age was from its agricultural predecessor. A world so different its emergence can only be described as a revolution." The literature is abound with hundreds of definitions, but the basic characteristics of the New Economy which has been reflected from these definitions are almost the same The basic features of the New Economy could be pin-pointed under the following set of points :

(a) Knowledge, knowledge capital, know-how and Intellectual Capital
(b) The internet
(c) Technology
(d) Information
(e) Intangible assets
(e) Knowledge sharing and the new forms of organisation
(f) Network effects
(g) Globalisation
(h) Highly competitive capital market
(i) Increase of the retail investors in the stock market

B. THE NATURE OF CHALLENGES THE FINANCIAL REPORTING FACES IN THE NEW ECONOMY

We all agree that the economy of 21st century is fundamentally different from the economy of the 20th century. However, the basic financial reporting system has undergone little change to capture the value driver of the new economy. This apart, the increasing participation of retail investors in the capital market has on one hand made the stock market more competitive and on the other hand, investors' demand for more information from the financial statements have grown. The investors now expect that the financial statement should provide them with sufficient information, which would be more useful and relevant from their decision making perspective.

The problem that confronts businesses, users of business reporting information, standard setters, and regulators is how best to understand and communicate the difference between the value of a company (usually expressed as the market capitalization) and the accounting book value of that company. One might simply attribute the entire difference to some ill-defined notion of "intangibles" and be done with the exercise. But that approach is circular and provides little feedback information to users of financial and business reporting information. There must be more going on and more that can be said. We can observe the market capitalization of a traded stock and observe ne accounting book value. We don't know

exactly why they are different, but we can make some reasonable speculations. A company's market capitalization might be decomposed along the lines below :

Decomposition of company's market capitalisation

1	Accounting book value	Rs. ***
2	+ (-) Market assessments of differences between accounting measurement and underlying value of recognised assets and liabilities	***
3	+ (-) Market assessments of underlying value of items that meet the definition of assets and liabilities, but are not recognised in the financial statements(for example, patents developed through internal research and development)	***
4	+ (-) Market assessments of intangible value driver or value impairers that do not meet the definition of assets and liabilities (for example, employee morale)	***
5	+ (-) Market assessments of entity's future plans, opportunities and business risks	***
6	+ (-) Other factors including puffery, pessimism & market psychology	***
7	MARKET CAPITALISATION	Rs. ***

In a perfect world, financial statements would include all items that meet the definition of assets and liabilities and provide decision-useful information about their values (items 1, 2, and 3). Business reporting outside of financial statements and notes would provide information and metrics about other value drivers and impairers of value and about plans, opportunities, and risks(items 4 and 5). The last adjustment (item 6) might be labeled simply as goodwill or intangibles.

The analysis of the above table helps us to identify the main challenges that the financial reporting system faces from the New Economy. They may be summed up in the following way :

1. Traditional financial statements focus on the entity's ability to realize value from existing assets and liabilities. Proponents argue that financial statements are largely backward-looking. A new financial reporting paradigm is needed to capture and report on

the entity's creation of value. This paradigm would supplement, or might replace, existing financial statements.

2. The important value drivers in the new economy are largely nonfinancial and do not lend themselves to presentation in financial reports. However, a set of measures could be developed that would allow investors and creditors to evaluate entities and compare them with one another.
3. The importance of intangible assets is the distinguishing feature of the new economy. By and large, existing financial statements recognize those assets only when they are acquired from others. Accounting standard setters should develop a basis for the recognition and measurement of internally generated intangible assets.

The above facts emphasise that financial reporting should disseminate more information to the users than it has been doing in the past. Researches have been going on in the different parts of the globe to find the ways in how best this could be achieved. In the following section we make an attempt to highlight some of the notable efforts in this direction.

C. SOME NOTABLE INTERNATIONAL WORKS TO MAKE FINANCIAL REPORTING MORE RELEVANT IN THE NEW ECONOMIC ENVIRONMENT

1) American Institute of Certified Public Accountants

In 1991, the American Institute of Certified Public Accountants (AICPA) formed a Special Committee on Financial Reporting (the Special Committee). While not directly concerned with the reporting implications of the new economy, the Special Committee's 1994 report touched on a number of topics discussed in this Special Report. In its introduction, the Special Committee observed :

> Increased competition and rapid advances in technology are resulting in dramatic changes. To survive and compete, companies are changing everything—the way they are organized and managed, the way they do work and develop new products, the way they manage risks, and their relationships with other organizations. Winners in the marketplace are the companies that are focusing on the customer, stripping away low-value activity, decentralizing decision making, reducing the time required to perform key activities, and forming new alliances with suppliers and customers—even competitors. They are setting the pace for others that must, in turn, reexamine their businesses in light of the increased competition.

In response to increased competition and changes in their businesses, companies also are changing their information systems and the types of information they use to manage their businesses. For example, they are developing new performance measures often designed to focus on activities that provide long-term value and competitive advantage, including non-financial measures such as product development lead time and financial measures such as economic value added .Can business reporting be immune from the fundamental changes affecting business? [page 2]

The Special Committee recommends that to meet users' changing needs, business reporting must make an effort to :

(a) provide more information with a forward-looking perspective, including management's plans, opportunities, risks, and measurement uncertainties.

(b) focus more on the factors that create longer term value, including non-financial measures indicating how key business processes are performing.

(c) better align information reported externally with the information reported to senior management to manage the business.

Interestingly, the Special Committee identified several of the topics discussed in this Special Report as "lower priority issues" according to the current evidence of users' needs. The Committee's study identified the following five areas that standard setters should not devote attention to at this time :

1. Value-based accounting model.
2. Accounting for intangible assets, including goodwill.
3. Forecasted financial statements
4. Accounting for business combinations
5. Alternative accounting principles [page125]

2) Financial Accounting Standards Board—Business Reporting Research Project

In February 1996, the FASB issued an Invitation to Comment, *Recommendations of the AICPA* Special Committee on Financial Reporting and the Association for Investment Management and *Research*, to solicit views on recommendations made to standard setters in both the AICPA Report and a similar paper published by the Association for Investment Management and Research (AIMR). Issue 1 of the Invitation to Comment asked: "Should the FASB broaden its activities beyond financial statements and related disclosures to also address the types of non-financial information that would be included in a comprehensive business reporting model?"

Overall, respondents had mixed views about FASB involvement with non-financial information. Some respondents opposed FASB standard setting for the disclosure of non-financial information.

Other respondents suggested that the Board be selective and initially limit its efforts to focusing on operating data and performance measures and reasons for changes in such data and key trends. Some suggested that the FASB take a primary leadership role in developing a comprehensive business-reporting model similar to the one developed by the Special Committee.

At a public Board meeting on January 29, 1998, the Board decided to undertake a research project on business reporting. The Board formed a Steering Committee to conduct the project and instructed the Steering Committee to :

1) Study present practices for the voluntary disclosure of certain types of business information that users of business reporting might find helpful in making investment decisions.
2) Develop recommendations for ways to coordinate generally accepted accounting principles (GAAP) and Securities and Exchange Commission (SEC) disclosure requirements and to reduce redundancies.
3) Study present systems for the electronic delivery of business information and consider the implications of technology for business reporting in the future.

The Steering Committee issued its report *Improving Business Reporting: Insights into Enhancing Voluntary Disclosures*, in 2001.That report described the findings of working groups that studied voluntary disclosures of business information in 10 industries. The report describes a framework for providing voluntary disclosures that includes five elements :

- Identify the aspects of the company's business that are especially important to the company's success. These are critical success factors for the company.
- Identify management's strategies and plans for managing those critical factors, in the past and going forward.
- Identify metrics used by management to measure and manage implementation of the strategies and plans.
- Consider disclosure about the company's forward looking strategies and plans.
- If disclosure is deemed appropriate, determine how best to voluntarily present those information .The nature of metrics presented should be explained and those metrics should be consistently disclosed from period to period

3) Canadian Institute of Chartered Accountants

The Canadian Institute of Chartered Accountants (CICA) has been working on a new economy project since 1994. The *Canadian Performance Reporting Initiative* (CPRI) has touched on a variety of topics discussed throughout this Special Report. The initial document to emerge from the CICA project was titled *Performance Measures in the New Economy*, authored by Robert I.G. McLean. In this report the following points have been highlighted :

- Need for better performance measures than that are provided by the existing accounting model
- Current accounting model does not adequately reflect economic reality for knowledge intensive business.
- Adequate accounting for knowledge-based industry or business will require the invention of a new accounting model.
- We are currently at an early stage in the exploration of alternative approaches to measuring, managing and valuing people skills, information and technological capabilities.
- The last paradigm shift in accounting involved a change in emphasis from valuing assets to measuring income and took place in the 19th.century.The new accounting model when fully developed will likely place equal emphasis on both asset valuation and income measurement.
- The new accounting model will likely incorporate both for accounting knowledge based business as well as green accounting.

4) Brooking Institution—Unseen Wealth

On October 24, 2000, Brookings announced preliminary release of two reports. The first report, *Unseen Wealth: Report of the Brookings Task Force on Understanding Intangible Sources of Value*, presents the work of the Brookings task force. Its main recommendation regarding Financial Reporting includes the following points :

1. As investors are interested in values not cost of internally generated assets, so the financial statements of the company either in the main format or in some other formats (such as in the footnotes in management discussion analysis) should present this information.
2. The financial reporting model should "begin to move toward a value-based system of accounting for corporate assets—both tangibles and intangibles—that would supplement the current cost-based system"

3. Disclosure of "value drivers" should be expanded and the disclosure should be provided at the same level of the business as are segment disclosures.
4. The Securities and Exchange Commission should expand safe-harbor protections to include disclosures about intangible value drivers.

5) Danish Agency for Development of Trade and Industry—Intellectual Capital Accounts

In 1998, the Danish Agency for Development of Trade and Industry published a study of *Intellectual Capital Accounts* developed with the cooperation of 10 companies. This study describes intellectual capital accounts in the following four categories which should find a place in the financial statement:

(a) ***Human resources***. This category covers statements about the composition, management and satisfaction of the human resources.

(b) ***Customers***. This category covers statements about the composition, management and satisfaction of the customers.

(c) ***Technology***. This category typically covers statements about the scope, function and application of the IT system.

(d) ***Processes***. This category typically covers statements about the scope, equipment and efficiency of the business activities.

6) Netherlands Ministry of Economic affairs

In 1999, the Netherlands' Ministry of Economic Affairs published *Intangible Assets, Balancing Accounts with Knowledge*.The Netherlands ministry asked four accounting firms to develop models for the presentation of information about intangible assets :

1) KPMG proposed a "dashboard" that portrays scores assigned to attributes of an entity's core competencies.
2) Ernst & Young proposed a reconciliation approach that begins with market capitalization and then deducts the fair values of tangible assets (net of liabilities) and identified intangible assets. The residual is characterized as the fair value of remaining intellectual capital.
3) PricewaterhouseCoopers proposed a disclosure approach that combined information about expenditures with non-financial performance metrics.
4) Walgemoed proposed expanded recognition of identifiable intangible assets on the face of the balance sheet, with those assets measured based on traditional accumulation of cost notions.

7) Organisation for Economic Cooperation and Development (OECD)

In June 1999, the OECD sponsored a Symposium on Measuring and Reporting Intellectual Capital : Experience, Issues, and Prospects.The symposium chairman observed :

> In a subsequent policy and strategy forum, a broad range of stakeholders from companies, governments, trade unions, accountants, standards setters, and the academic community addressed the question of how to facilitate development of internal and external company reporting of intellectual capital. Forum chairman, Stuart Hornery, chairman of Lend-Lease Corporation, drew the following conclusions :
>
> 1. The process of value creation in companies is changing. There is a need for better information on intellectual capital, its relation to tangible capital, and its role in value creation. Financial data are evolving, but, alone, are not sufficient information.
> 2. International organisations, governments, standards setters and other stake holders should encourage experimentation that would lead to general principles or guidelines for reporting key indicators of intellectual capital and information on value creation. They should systematically monitor and evaluate the results of such experimentation.
> 3. There is broad support for the creation of a framework for voluntary compilation at the enterprise level of a number of key indicators using all possible approaches, including company benchmarking. The framework for reporting should focus on areas that mostly matter to company performance.
> 4. Employees, suppliers, and customers are involved increasingly in the value creation process. Improvements in reporting should aim to inform them better.
> 5. There is a need for better understanding of the innovations in reporting. New approaches are moving towards Internet based real-time reporting; greater availability of information means that more information about a company comes from multiple sources. As a result more internal information is available externally.
> 6. Businesses are concerned that disclosure of information on intellectual capital and value creation should be useful to business, as well as stakeholders. Many are actively experimenting. It is, however, too early to consider mandatory changes in rules that are affecting such disclosure. Any requirements need to be mindful of costs and benefits

8) Institute of Chartered Accountants of England and Wales (ICAEW) — New Measures for New Economy Charles Leadbeater (March, 2000)

Leadbeater proposes three alternative approaches that he labeled incremental, radical, and hybrid.

1. ***The incremental approach*** seeks gradually to fill in values for the intangible assets which traditional balance sheets overlook. Traditional financial accounts would remain the focus of corporate reporting but they would be augmented by *relevant, robust information* on intangibles. This approach would involve accounting procedures used routinely in corporate acquisitions to value intangibles as well as quasi-market valuations yielded by techniques such as real options. The incremental solutions would comprise three steps:
   a) This approach would be based on non-financial measures that were relevant, relatively easy to collect and had a proven relationship to market value. These measures would be different for different industry. The aim would be to set industry specific standards for reporting robust non-financial information on intangibles which could be independently audited.
   b) Companies should provide 'safe havens' in their accounts for intangibles to be valued as assets without putting them on the actual balance sheet. This would allow the companies to adopt a more flexile approach by stating possible ranges for intangible asset values. The safe haven would be a way of valuations of intangibles in 'quarantine' before allowing them to migrate to balance sheet.
   c) The companies should provide a set of revisable rolling accounts . It might not necessarily be wise to cpitalise the R & D. of a high risk technology business at an early stage of development because the future benefits would be very much uncertain. But, at some point, when the technology and the market has become less volatile, the capitalisation may have become more realistic. It might then be worth restating past accounts to show how they would have looked if the R&D had been capitalised. Accounts are the financial history of a company and like most histories they should be revised in the light of new information.

The incremental approach is designed to allow companies to gradually to combine traditional and novel ways of valuing assets. It would permit them to deal more effectively with volatility and uncertainty by providing safe havens and revisable rolling accounts. Industry standards for disclosing relevant non-financial information about intangibles would allow more robust links to be made between investment in intangibles and market valuations.

2. ***The radical approach*** is to devise entirely new balance sheets for companies— Intellectual Capital Balance Sheets which put intangible assets at the heart of the accounts. Financial information is included but as a measure of success and as a resource for investment. The generation and deployment of intangible assets forms the core of these new models. The best known of these new balance sheets is the intellectual capital report by Swedish insurance company Skandia. Another Swedish approach is the intangible asset monitor developed by management consultant Karl Erik Sveiby.

Another variation of the Intellectual Capital Balance Sheet approach is the Intellectual Capital Index developed *by Goran and Johan Roos.* It provides an intellectual capital tree which divides the IC into human capital, organisational capital and customer relationships. A company's organisational capital can then be further divided into business renewal and business process capital. The process of drawing up such a balance sheet often forces companies to focus on the intangible assets and competencies that matter to them most.

However, it appears that the new system although looks elegant but requires large investments in data collection.

3. ***The hybrid Approach*** involves far more sweeping changes, not just to the way managers and accountants value intangibles but also the value placed upon them by society as a whole. An underlying assumption of the debate about intangibles is that there should be an accounting solution to the difficulties of valuing them. This may involve gradual or radical reform but it would essentially involve accountants in drawing up a balance sheet for a company.

The hybrid approach would especially recognise that more reliable values are for intangibles will only emerge if there are more open, active and 'thick' markets to trade them, or at least financial instruments linked to intangibles. There are two main attractions for development of new markets for intangibles.

First, intangibles are difficult for accountants to value because they are volatile and uncertain, their value shifting with markets and demand. Accounting measures of intangible value are too slow, cumbersome and backward looking to keep pace with this change. What is needed is constant adjustment of value of intangibles according to market conditions, technologies, regulatory changes and so on. Financial market modes are much better at this than accounting measures.

Second, accounting is at its best when it is recording observable, discrete transactions. Intangible assets create a problem for the accountants because they are difficult to disaggregate and so are hard to trade. To value intangible accountants need either to acquire radically new skills to value assets which are not traded or to create open markets and a trade in intangibles which they can record.

The hybrid approach argues for the creation of new financial markets to allow the trade of options on intangibles. Investors would be able to invest in companies as combinations but also on a disaggregated basis. An investor might wish to invest in Nestle, which hold many consumer brands, but may also wish too invest in one like Kitkat.

This approach would see the creation of a new breed of financial market — The intangible options market, a market -based system of valuing future prospect of intangible assets, which made up a business. Accountants would not attempt to measure intangible values put on intangibles by the financial markets.

A comparative analysis of Incremental, Radical and Hybrid approach has been provided in the following table :

A comparative analysis of Incremental, Radical and Hybrid Approach

Incremental	Radical	Hybrid
• Industry specific rather than general	• New intellectual Capital Balance sheets	• Big changes in the valuation of assets
• Safe havens	• Intangibles placed at heart of accounts	• Recognition of need for markets to trade them or financial market linked to intangibles
• Revisable rolling accounts	• Financial information included to measure success	• Market-based system for valuing assets could be reflected in accounts
• Gradualism would enable investors, managers and regulators to learn as they go	• Drawing of IC balance sheet focuses managers on intangibles	• Accountants would not try to measure intangibles but record financial markets' valuation of them
		• Accounting and market-based measures of value would therefore develop in tandem leading to new markets - not new balance sheets
But,	But,	But,
1. Might lead to patchwork quilt method of valuing companies, thereby undermining consistency and reliability of accounting framework	1. Large investment in data collection	1. Limitations of intangibles that could be traded
2. Risk of not going further faster	2. Assets measured which have no bearing of financial performance	2. Options market that would lead to unreliability and volatility
3. Might not make intangibles prominent enough	3. IC inventories could be too cumbersome for fast moving markets	
	4. Less reliable in putting reliable valuation on intangibles for outside investors	

The main propositions of notable international works are summarised in the following table :

Main Propositions of Notable Works

Agency	New Paradigm	New Metrics	Intangible Asses
AICPA -Jenkin's Committee Report		*	
FASB- Business Reporting Research Project		*	
Canadian Institute of CA-Performance Reporting Initiative	*	*	
Brooking Institution- Understanding Intangible Source of Value		*	*
Danish Agency for Development of Trade & Industry- Intellectual Capital Accounts		*	
Netherlands's Ministry of Economic Affairs- Intangible Assets, Balancing Accounts with Knowledge		*	*
OECD		*	
ICAEW- New Measures for New Economy		*	*

D. HOW FINANCIAL REPORTING SHOULD COPE WITH SUCH CHALLENGES?

The major international works that have been cited in the previous section have called for restructuring or modifying of the financial reporting in the following directions to make itself ready to meet the challenges of the new economy :

a) Developing a new paradigm for financial reporting
b) Incorporating non - financial measures along with the traditional financial measures in the reporting statements
c) Formulating new principles in the field of recognition and measurement of self generated intangible assets

To keep this paper within a reasonable length, we are confining our discussions to the first two areas mentioned above, i.e. development of a

new paradigm of financial reporting and incorporation of non -financial measures in the reporting statements.

i) New reporting paradigm

In this section we present the Total Value Creation Model (TVC) as suggested by the Canadian Institute of Chartered Accountants (CICA) and the model Accounting For The Future (AFTF) as suggested by Humphrey Nash.

1) The CICA Total Value Creation(TVC) System

The most ambitious part of the Canadian Performance Reporting Initiative (CPRI) is a new reporting model aimed at capturing an entity's value-creating activities, which the proponents distinguish from value-realizing activities. The CICA applied for a U.S. patent in May 2000, on behalf of a collaborative global entity that is being formed to further develop the concepts. The August 2000 issue of *CA magazine* makes the case for TVC this way :

> Total Value Creation is the profession's response to concerns regarding the relevance of traditional accounting for performance measurement in the new knowledge-based economy. CPRI leaders—whose mandate is to provide innovative performance measurement tools addressing information and reporting needs in areas like intellectual capital, environmental performance and measurement of shareholder value creation—and others see TVC as a major step leading to internationally accepted measurement and reporting standards on value-creation performance. TVC's creators claim that the new method will allow management, boards, investors and other stakeholders to assess an organization's performance and determine if, and to what extent, it is creating value, even though revenues are for the future. In other words, it's been designed to say where things are going instead of where they're coming from. TVC is a system to rigorously measure and report on value-creation performance. It is the next step along a continuum, which begins with financial reporting and moves through non-financial performance measures to techniques that link performance to value creation. Using elaborate models, the system tracks down financial and non-financial performances and reports in a way that will help managers to evaluate scenarios and then choose the one that will create the most value.

How does TVC address the limitations of the traditional accounting framework?

The TVC System, embodied in TVC Software, comprises a set of inventions and innovations that are designed to overcome the limitations

of the traditional accounting framework, as seen from a 21st century perspective. TVC responds to the need for a reliable system that measures and reports on value creation that is not based on past transactions, but rather looks forward to future value streams. The TVC system is intended to be supplementary to, and is not a replacement for, traditional financial accounting that measures value realized through transactions with third parties.

The idea of measuring value creation is not new. Most attempts to measure value creation have been based on numbers derived from historical performance. However, there is no necessary relationship or correlation between historical performance and future performance. For newly-established companies, with no track record, historical information is simply unavailable.

Value creation as measured by the TVC system is based on future value streams, not historical performance. It uses discounted flow techniques to calculate the Present Value of future financial value streams. PV/DCF calculations are not unique to the TVC system. What is unique is the method by which these calculations are used to generate a measure called TVC Outcome Variance, which in turn can be analysed in order to reveal which events are responsible for changes in Present Values from one time period to another time period.

Most previous attempts to measure value creation have focused only on shareholder value. The TVC system has a broader focus, and measures financial value created for all key stakeholders. It is increasingly important for enterprises to measure value created for customers, employees, and other stakeholders, in addition to shareholders.

Traditionally, projections of future value streams (as compared with historical results as measured by the traditional accounting system) have been regarded with a high degree of skepticism, as being subjective, susceptible to manipulation, and subject to the inherent uncertainty of future events. The TVC system overcomes these traditional limitations of future projections in the following ways :

- It is event-based. Events play the same role in the TVC system as transactions play in the traditional financial accounting system. (In fact, one can think of transactions as simply a specific type of event.) The calculation of future value streams in the TVC system is based on an explicit linkage of all assumptions to future and past events.
- The TVC Event/VSM Matrix is continuously updated as events take place, so that at any point in time, it reflects the most recent assumptions;
- The linkage to events provides a mechanism for accountability. It will be evident as the future unfolds whether events take place

as anticipated, or not. The analysis of TVC Outcome Variance requires a reconciliation of all previous event-related assumptions to updated assumptions and/or events which have transpired in the interim.

- The linkage to events also provides a mechanism for assessing the reliability of the results generated by the TVC system. Reliability is assessed by calculating the degree to which the value stream forecasts are based on assumptions about future events, or events that have already transpired. The TVC Reliability Index also tracks the accuracy of forecasts over time.
- It is inherent in the TVC system that users are provided with access to the TVC Event/VSM Matrix. A user who might otherwise be skeptical about projections of future value streams has the opportunity to review the event-based assumptions on which these projections are based. Furthermore, the user also has the ability to modify those event-based assumptions and determine the extent to which these modifications influence the results of the TVC calculations.
- The TVC system includes a method of providing users with a way of assessing the risks associated specific value streams, in a way that distinguishes these risks from those that apply to the enterprise as a whole or the industry. This does not eliminate the uncertainty that is inherent in future events, but does provide a way of quantifying the related risks.

The calculations of financial value creation embodied in the TVC system can be deployed in two fundamental situations.

- The first, referred to as TVC Vision View, involves using the TVC system to help make decisions in a strategic planning situation. In TVC Vision View, the calculation of TVC Outcome Variance is used to compare the results of alternative future scenarios.
- The second, referred to as TVC Performance View, involves using the TVC system to track performance over time. In TVC Performance View, the calculation of TVC Outcome Variance is used to compare the results achieved in a specific time period with the results that were previously anticipated.

In sum, the calculations of financial value creation embodied in the TVC system are, in a knowledge based economy, an important supplement to traditional financial accounting, inasmuch as they :

- can help managers, providers of capital, and other stakeholders assess the results of alternative courses of action;

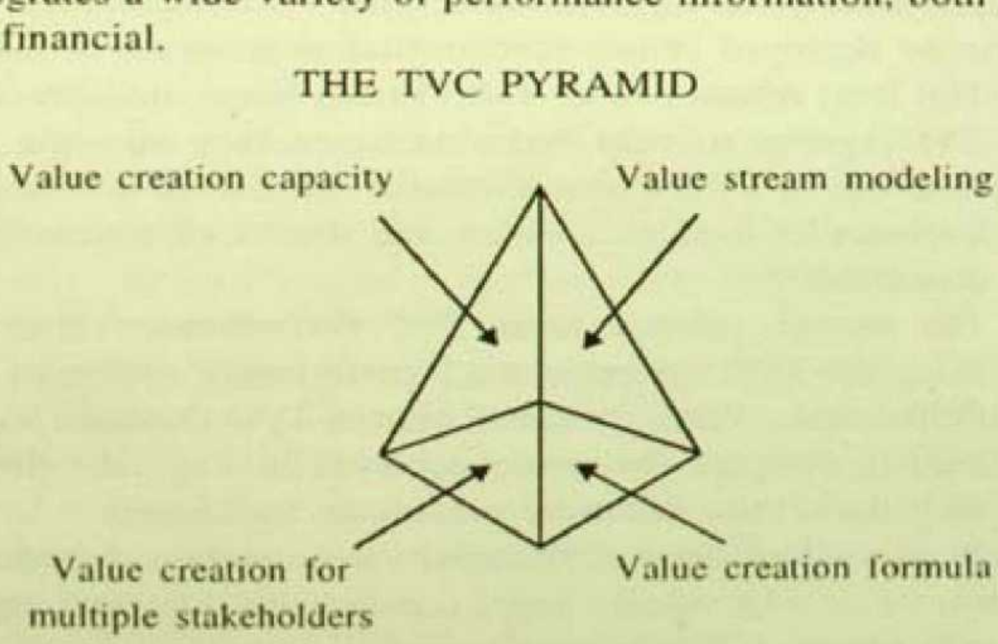
- can help managers, providers and capital, and other stakeholders assess the performance of an enterprise in creative value over time, even through that enterprise may as yet not be generating profits as measured by the value realization accounting system.

However, the TVC system goes beyond the calculation of future financial value streams. It also reports on non-financial value streams, and does so in a way that provides a holistic, integrated perspective of organizational performance in value creation. It does this by presenting four simultaneous perspectives into value creation :

- an organization's TVC Formula, that documents the fundamental elements of the organization's strategy for creating and realizing value;
- an organization's TVC Value Stream Model, (VSM) which calculates financial value creation for multiple stakeholders using an event-driven discounted cash flow analysis applied to future value streams;
- an organization's TVC Capacity, which consists of the capabilities, infrastructure and networks that are required to generate the value streams ;
- TVC for Stakeholders, which measures financial and non-financial value streams from the perspective of key stakeholders.

We have adopted the concept of a TVC Pyramid to symbolize the fact that each of these perspectives provides a unique viewpoint into the same underlying reality. The TVC Pyramid provides the mechanism by which TVC integrates a wide variety of performance information, both financial and non-financial.

THE TVC PYRAMID



In shifting the focus from shareholders to a broader set of stakeholders, one of the challenges that must be addressed is obtaining the

information needed to understand performance in value creation from a stakeholder perspective. In the TVC System, stakeholders or users of the system are not simply passive recipients of information, but have the opportunity to interact directly with the system in four fundamental ways :

- Stakeholders have an opportunity to input direct feedback on enterprise performance as they have experienced it from a customer, employee, or other stakeholder perspective;
- In interacting with the TVC System, stakeholders can select the perspective that is most useful to them, the level of detail that is appropriate, can see the effect of modifying assumptions, and can store their assumptions for future use.
- Stakeholders can also review other users' assumptions, where those users have given appropriate permissions.
- The TVC System provides stakeholder/readers with real-time access to :

(a) a continuously updated discussion and justification of the main events /Assumptions built into the Base Case Scenario;

(b) a continuously updated Management Discussion and Analysis of the Base Case Scenario Outcomes.

The TVC System provides related mechanisms to identify specific responsibilities for keeping this information continuously updated.

The TVC system incorporates some elements that are comparable across industries, some elements are industry or sector specific, and some elements that are firm-specific. To facilitate the implementation of TVC, the TVC system provides for the capability of industry or sector-specific downloadable reporting templates that individual companies can then further customize to meet their specific needs. The API for these templates will be licensed on an open-source basis so that various enterprises can offer templates on a freeware, shareware, or commercial basis.

The same mechanism of downloadable templates can be used to provide for two other related functionality :

(c) To enable supplementary reporting simultaneously in multiple formats in accordance with emerging environmental, social, and similar reporting standards, drawing on the same underlying data as is used to prepare TVC reports. At present, there is no system that enables these multiple types of reports to be produced based on the same underlying data.

(d) To enable financial reporting simultaneously in multiple formats in accordance with Generally Accepted Accounting Principles as defined by various country and international standard-setting bodies. To accomplish this in the past required laborious manual computations; but the downloadable template feature of the TVC enables this to be automated.

To provide for a more efficient and timely way of enabling companies to obtain assurance from an external auditor on TVC reports, the TVC System has a set of built-in Self-Auditing Routines that ensure the integrity of the underlying data and calculations. The integrity of the self-auditing algorithms are assured by built-in encryption and various other devices to guard against unauthorized tampering. The Self-Auditing Routines are designed to interact with parallel systems operated and maintained by a qualified and trained auditor. These automated systems, combined with other necessary non-automated procedures, enable a qualified auditor to provide assurance on a continuous, real-time basis. TVC Downloadable Assurance Templates are used to help in the installation of the Self-Auditing Routines

One of the advantages of traditional financial reporting is the comparability of financial reporting across companies and industries. TVC reporting is, by contrast, more company-specific. There is still a need, however, to be able to compare company performance in creating value. This need is addressed by incorporating into the TVC system support for value-creation benchmarking through a network of TVC Benchmarking Service Providers.

2. *Accounting For The Future (AFTF)—Humphrey H. Nash, Sr. (1998)*

In 1998, actuary Humphrey H. Nash, Sr., published a monograph on his proposed "value-added" approach to accounting. Like the TVC ® model, Mr. Nash uses a system of projected future cash flows to present a corporation's activities in financial terms. Unlike the TVC ® model, he casts the results using traditional labels of assets, liabilities, and equity—but with new meanings.

The main features of AFTF have been summarised under the following set of points :

- The **AFTF value** is the present value of all expected future net cash flows discounted at the market cost of capital.
- The market cost of capital is the yield rate the shareholders require before they will buy the company's stock.
- The AFTF value at the end of a time period less the AFTF value at the start of the time period (increased at the cost of capital) is the **value added** during that time period.
- **AFTF assets** are defined to be the present value of all expected future cash flows *into* the company.

Traditional Accounting vs. AFTF Accounting —Comparison with an example

Example : A computer with a useful life of 5years costing Rs.200000 is purchased at the end of the year on Dec31, 2000 and replaces two clerks

whose combined salary costs Rs. 100000 per year (assumed to be payable at the end of the year)

Traditional Accounting

Year	Depn.	Year-end Book Value	Net Cash Flow	Traditional Earnings
2000	——	200000	(200000)	0
2001	40000	160000	100000	60000
2002	40000	120000	100000	60000
2003	40000	80000	100000	60000
2004	40000	4000	100000	60000
2005	40000	0	100000	60000
Total			300000	300000

AFTF Accounting

(Cost of finance 15%)

Year	Year end AFTF Value	AFTF Value Added
2000	335300	335216
2001	285600	(-)49616
2002	228400	(-)57200
2003	162600	(-)65800
2004	87000	(-)75600
2005	0	(-)87000
Total		0

Problems with developing a new reporting paradigm

Proposals for a new paradigm have a certain appeal. Still, there are several conceptual and practical problems with developing a new reporting paradigm.

Cost and complexity

Developing cash flow projections for a single project can be costly and difficult. The cost of implementing a prospective accounting model in a complex organization would be considerable - it essentially requires a second management information system. Any attempt to do variance analysis would require that the prospective system be integrated with traditional bookkeeping systems. Only then can the reporting system distinguish between "variance" and "variance attributable to." A prospective reporting system, then, does not eliminate the traditional cost-

accounting and cost-allocation problems encountered in any management reporting system and makes those problems more difficult.

Extension

To be effective, a prospective measurement requires a discrete series of cash flows with a reasonably definable beginning, middle, and end. Perhaps this is why illustrations of prospective models usually focus on project-oriented businesses and the analysis ends with the last cash flow from the last active project. However, most businesses go through cycles of development and commercialization. The modern business is a continuing entity, rather than a limited-life venture, and many business activities do not have an easily defined life.

Current accounting applications of present value are "closed-book" computations. Pension accounting does not assume a constant influx of new employees, because the entity has no obligation to these yet-to-be-hired individuals. In this way, the definition of a liability imposes an important limitation on an otherwise-uncontrollable computation. Prospective reporting models face a dilemma. If a model focuses only on current projects or imposes limitations on the time horizon, it will omit some of the perceived value of the entity. If the model doesn't impose some kind of limit, the result is unbounded and undefined.

Definition, recognition, and measurement

Commentators often dismiss the framework of traditional GAAP as arcane and difficult. Arcane it may be, but the basic questions are not all that difficult :

(a) What kinds of things go in financial statements (definition)?
(b) When do those things get reported in the statements (recognition)?
(c) How are those things quantified in the statements (measurement)?
(d) What happens when things change? Do we care (recognition) and if so, how much (measurement)?

A prospective system can't avoid those questions. While the designers sometimes profess themselves unconcerned with notions like *assets*, they must develop some similar set of decision rules so that the proposed system will provide information that is comparable and comprehensible from one reporting entity to the next. Disclosure, no matter how elaborate, will not solve the problem.

Existence and completeness

The TVC proposal calls for "professional assurance regarding completeness and internal consistency of the disclosed assumptions, the

consistency of the discounted cash-flow model, and the correct TVC applications." Students studying auditing are taught that financial statements make two complementary assertions (among others) :

(a) Existence—The assets and liabilities presented in a balance sheet exist and belong to the reporting entity.

(b) Completeness—None of the entity's assets and liabilities have been left out of the balance sheet.

Now, a company's assertion that it owns five (and only five) aircraft is easy to examine. But a prospective system is a collection of plans and projections. A company's assertion that it has five (and only five) projects presents a different challenge. Most advocates of prospective systems would agree that there must be a reasonable set of expectations. Defining and controlling "reasonable" will be no easier in a prospective accounting system than in today's GAAP.

ii) Non-financial measures

As the most of the value-drivers of the new economy are non-financial, so the disclosure of non-financial information in the published annual report is required to bring about transparency in the annual report. However, the traditionalists argue that non-financial information lack objectivity and hence be excluded from the reporting statement. In this context, we can quote Karl E. Sveiby

"It is tempting to try to design a measuring system equivalent of double entry bookkeeping with money as the common denominator. It is an established framework with definitions and standards and therefore 'common sense'.

This is precisely the reason why we should break with it.

If we measure the new, like knowledge, with the tools of the old, we won't "see" the new.

> *Any measurement system is limited by Heisenberg's uncertainty principle (1927) which says that it is impossible to measure simultaneously the speed and the position of particles. The physicist Bohr argued that this means that the observer is always involved in the measurement and that the physical world does not have well-defined attributes.*
>
> *If truth is in the eye of the beholder in the physical world it is even more so for the world of business. There is no difference between money measures and other measures. Both are uncertain and all are dependent on the observer. There exist no "objective" measures. The main reasons why the money measures seem more "objective" and "real" are that they are founded on implicit concepts of what a company is and that the measures have been*

around for so long that they are guided by definitions and standards.

Once measures have been selected, they color what we see and how we act, and the problem with translating actions into money is that very few people in an organization handle money directly. Most of them work by using their competencies in the service of customers. Money is merely a proxy for human effort, and the 500-year-old system of accounting sheds little light on the vital processes in organizations whose assets are largely non-monetary, and intangible.

As of today, there exists no comprehensive system that uses money as the common denominator and at the same time is practical and useful for managers. Depending on the purpose for measuring, I do not think it is necessary either. Knowledge flows and intangible assets are essentially non- monetary. ***We need new proxies.***

Most companies measure at least some of their intangible assets and they use non-monetary indicators particularly for measuring operational efficiency. Manufacturing companies have for instance measured their output in "tons per hour", hospitals and hotels measure bed utilization, schools measure average marks, universities measure number of PhD dissertations per year, etc."

The other two intangible areas covered in this book are much more recent; customer relations, such as satisfaction levels and competence related measures, such as employee satisfaction and retention are still not monitored on a regular basis by most companies. The problem is not that "intangible measures" are difficult to design. The problem is more that the outcomes seem difficult to interpret. Customer surveys, for instance, when used systematically yield an abundance of data which managers find difficult to correlate with changes in business performance. Kodak for instance, does a monthly survey of some 300 customers in each area of the business, asking specific and open-ended questions.

As a Kodak manager says :

"The answer is almost impossible. We know we are often measuring dissatisfiers rather than satisfies. He airs most managers' frustration by the lack of correct and certain measures. The Kodak manager, like most managers, believes that the money measures are more "real" than other data and he has no framework that he can use to interpret his data. His framework must be replaced by a new

one, and a replacement which fits today's reality could be some kind of "knowledge perspective".

Several research studies have been published which identify the areas on which non-financial information are needed and the types of information that should be presented and disclosed. In this context reference of **Balanced Scoreboard** may be made. The Balanced Scorecard's creators recommend that companies assemble a set of 23–25 measures in four areas:

(1) Financial measures (5) address the question, "How do we look to shareholders?"

(2) Customer measures (5) address the question, "How do our customers see us?"

(3) Internal process measures (8–10) address the question, "What must we excel at?"

(4) Learning and growth measures (5) address the question, "Can we improve and create value?"

An example of Balanced Scoreboard of a semiconductor company with pseudonym electric Circuit Inc. (ECI)

(Adapted from The Balanced Scoreboard that drive performance ; Kaplan & Norton ; Harvard Business Review Jan. Feb.1992)

Financial Perspective Goals	Measures
Survive	Cash flow
Succeed	Quarterly sales growth and operating income by division
Prosper	Increased Market Share and ROE

Customer Perspective

Goals	Measures
New Products	Percent of sales of new product
Responsive Supply	On time delivery (defined by customers)
Preferred Supplier	Share of key account. Ranking by key accounts' purchase
Customer Partnership	Number of cooperative engineering efforts

Internal Business Perspective

Goals	Measures
Technology Capability	Manufacturing geometry vs. Competetion
Manufacturing Excellence	Cycle time, Unit cost yield
Design productivity	Silicon efficiency. Engineering efficiency
New Product	Actual introduction schedule vs. plan

Innovative and learning perspective

Goal	Measures
Technology Leadership	Time to develop next generation
Manufacturing learning	Process time to maturity
Product focus	Percent of product that equal 80% of sales
Time to market	New product Introduction vs. Completion

Non-financial metrics are disclosures, not information recognized and measured in financial statements. Accountants and standard setters have a well-articulated framework for understanding recognition and measurement problems, but the same cannot be said of disclosure problems. Nevertheless, we can make a few observations about the elements of a useful presentation of non-financial metrics :

1. Metrics presented in a systematic and ordered way (like a matrix or summary) are more useful than those located in several different places.
2. Metrics presented in isolation have little usefulness. To be useful, metrics must be presented in the context of the entity in its industry and markets. This suggests that metrics for a diversified company are not as useful as the metrics for its business segments.
3. Unusual or innovative metrics, like customer or employee satisfaction indices, are interesting. However, traditional measures like same-store sales or employee turnover can provide considerable insight into the entity's relationship with its customers and employees. Those traditional measures are likely to be less costly to develop, more understandable, and more comparable from one entity to another.
4. The change in a metric from period to period is more useful than a single figure. This places a premium on consistency from period to period.
5. An individual company's metrics can provide useful information, but that information is more useful if it can be compared with comparable metrics presented by other companies.

E. INDIAN RESPONSE

Indian response to the challenges of the new economy has been slow but steady. The Institute of Chartered Accountants of India (ICAI) has published 13 new accounting standards from the year 2000 to July 2002, namely, (a) AS 16 Borrowing Costs (b) AS17 Segment Reporting (c)AS 18 Related party Disclosures (d)AS 19 Leases (e)AS 20 Earnings per Share

(f) AS 21 Consolidated Financial Statements (g) AS-22 Accounting for Taxes on Income (h) AS 23 Accounting for Investments in Consolidated Statements (I) AS 24 Discontinuing Operations (j) AS 25 Interim Financial Reporting (k) AS 26 Intangible Assets (l) AS 27 Financial Reporting in Joint Ventures (m) AS 28 Impairment of Assets.

Apart from ICAI, The Securities and Exchange Board of India (SEBI) has also come forward to give wider information to the shareholders on certain important aspects of the company. For example, in the year 2000 clause 49, a new clause has been added in the Listing Agreement. Annexure 2 to clause 49 asks for inclusion of certain items in the report of Corporate Governance as a part of Director's Report in the annual report of the companies. They include among other items a brief statement on company's philosophy on code of governance, information about Audit Committee, Remuneration Committee, Shareholders' Committee, General shareholders' information, etc.

Indian Companies on their own have also come up with voluntary disclosures on different areas which are of interest to the stakeholders of the company. For example, Mission and value creation Statement (ITC), Value chain and comparative advantage statement (Dr. Reddy's Labboratory) Director's Responsibility Statement (Infosys) Geographical Segment Reporting (Infosys) Operations Review (Ranbaxy) Human capital (Zee Telefilms) Economic Value Added (HLL) Consolidated Accounts (HLL) Reconciliation with US Gap (Infosys, Reliance, ICICI) have found place in the published Annual Report of the companies.

F. CONCLUDING OBSERVATIONS

The perceived shortcomings of business and financial reporting can not be overcome overnight by following any particular model or method. We have in our paper described important contributions from the United States, the United Kingdom, Canada, Denmark, the Netherlands, and the Organization for Economic Cooperation and Development. Swedish companies have been leaders in providing non-financial metrics. Although, one standard setter might take the lead, but to answer the challenges of the new economy what we need is a joint and collective effort comprising talent and insight available in the broader international arena.

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FROM FIXED TO FLEXIBLE EXCHANGE RATES : THE CASE OF INDIA

RANAJOY BHATTACHARYYA

1. INTRODUCTION

The government of India's New Economic Policy of 1991 had two parts. The main aim was to change the structure of the economy from a government oriented one to a market oriented one. This was the long term objective which was expected to be implemented in phases over a period of ten or twenty years. The other objective was to stabilise the economy while the policies are being implemented. These policies mostly consisted of monetary and fiscal policies and were clearly short term in nature implemented from time to time and adjusted or withdrawn according to the prevailing situation at any point of time.

The journey from a mixed economy with socialistc objectives to a free market economy with competitive objectives has to be an extremely arduous one anywhere in the world. For a country as massive and as complex and chaotic as India it is natural to expect a smooth journey to be next to impossible. However apparently that is not what the policy makers thought when they embarked upon this perilous path in 1991. Neither did they have any choice as the policies were a part of the conditionalites of a massive loan that came form the IMF in 1990.

The IMF's liberalization package touched upon every aspect of the economy. Since simultaneous implementation of all of them was not feasible, a question of sequentiality in the policies came to the fore and was much discussed by economists in the early 1990s. One of the first policies to be implemented was the exchange rate policy. It should be understood that before the decade of the 1990s India's exchange rate was more or less fixed. Between 1947 and 1975 the rupee was pegged to the pound sterling after which it was pegged to a basket of currencies[1]. The Reserve bank of India announced the exchange rates on the basis of the daily exchange rate movements of a select number of currencies (of India's major trading partners). The fluctuations were intended mainly to keep the real exchange rate constant.

From this system of fixed (or "implicitly adjustable peg") exchange rate the Indian government shifted to a flexible exchange rate system (in the current account) by 1992-93. The shift was not achieved overnight. In

fact the Indian government took a series of policies to minimise the impact of the change in the exchange rate. This paper analyses the impact of these intermediate policies on the Indian exchange rate. More specifically we ask the following question: what is the exact path that the Indian exchange rate took in its journey from the government determined rate to the "equilibrium" rate[2]. The theoretical model implicitly assumed throughout the paper is discussed in section 2. In section 3 we look at the nominal exchange rate to determine its path. Section 4 concludes the paper[3].

2. THE THEORY

The government of India took its first step towards full convertibility in the current account on July 1, 1991 when it devalued the rupee. The exchange rate prevailing in June 1991 was about Rs 21.1 per US dollar. As we have already argued this exchange rate was fully controlled by the government and can be considered as virtually fixed from the free market point of view. In figure 1, where we have drawn the standard textbook representation of the foreign exchange market, we denote this fixed exchange rate as $\underline{e}$. At this exchange rate there is an excess demand of US dollars to the extent of AB. Had markets been free this excess demand for dollars would have driven up the relative price of dollars and driven down the relative price of rupees. The final outcome should have been an exchange rate of e^*. The government, by law, had prevented the attainment

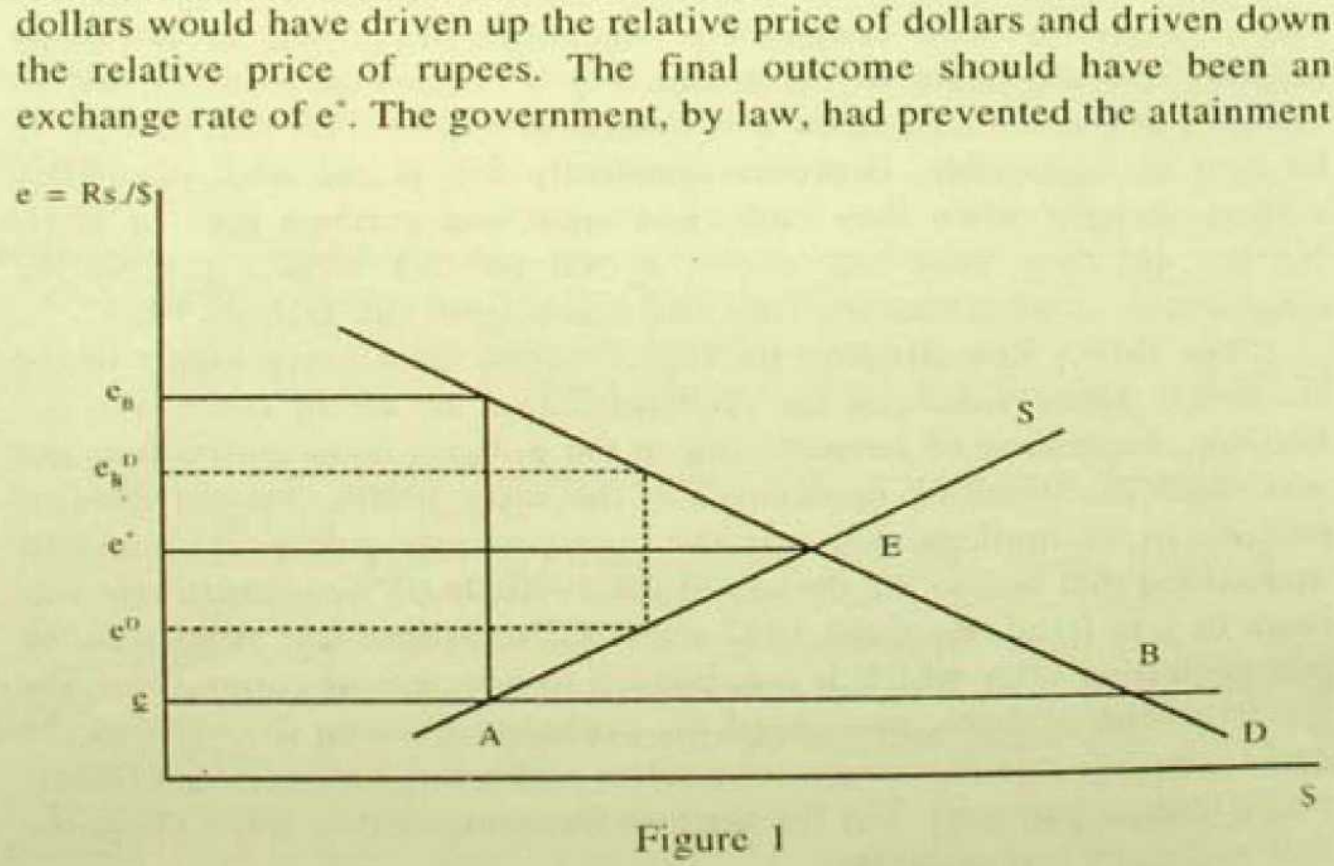

Figure 1

of e^* – this being the essence of the "fixed" exchange rate system as applied to India. What is the value of e^*? Given a fixed or a government controlled exchange rate system, e^* is unobservable so its value is unknown. Can we

approximate it? In this paper we will approximate the value of e^* by the value that India's exchange rate attained as soon as the rupee was made fully convertible in the current account. The rupee was made fully convertible in the current account in August 1994. In August 1994 the value of the rupee was exactly Rs 31.3 to the US dollar. If we allow for a one month lag for the exchange rate to adjust fully to convertibility then instead of August we can take September of the same year. In September 1994 the value of the rupee was approximately Rs 31.4 to the dollar. So a reliable estimate of e^* can be taken to be between Rs 31.3 and Rs 31.4 per US dollar.

Let us now turn to the Indian government's dilemma as soon as the policy of flexible exchange rate was decided upon. $\underline{e}$ was observable at Rs 21.1 per US dollar, e^* was unobservable and, at that time there was no way of finding out exactly what it would be like. Luckily however there was another alternative available. If $\underline{e}$ is the fixed exchange rate (and making the simplified assumption of nonexistence of Hawala transactions[4]) there should be a black market exchange rate of e_B prevailing in the market. This e_B was observable at about Rs 40 to the US dollar (at its minimum)[5]. Since e^* is surely to be between $\underline{e}$ and e_B, the range in which e^* should be found could be ascertained. The range was a massive Rs 20 to the US dollar. Thus any sudden change in policy towards full convertibility was expected to cause large scale macroeconomic instability. The attainment of e^* was thus obtained by a series of policies which would make the change more gradual.

The major exchange rate policies undertaken by the government of India between 1991 and 1994 were :

1) Rupee devalued by 8 % in July 1, 1991.
2) Rupee devalued by 11% in July 3, 1991.
3) The rupee made partially convertible on March 1992 in the trade account, with the introduction of liberalised Exchange Rate Management System (LERMS). Under the system, 40 % of all foreign exchange earnings was to be surrendered at the official exchange rate, remaining 60 % could be converted at a market determined rate. The foreign exchange surrendered at official exchange rate was utilised to import essential items. The foreign exchange converted at the market rate was available to finance all other imports.
4) The Foreign Exchange Regulation Act (FERA), 1973 amended on January 1993.
5) The dual exchange rate system of March 1992 unified. Rupee made fully convertible on the trade account on February 1993.
6) Full convertibility of rupee on the current account. Art VIII status of IMF attained in August 1994.

Policies 1 to 5 were expected to close the gap between e^* and $\underline{e}$ sufficiently so that by the time policy 6 (full convertibility in the current account) is taken there will be no sudden jolt on the exchange rate. As is obvious from figure 1 this would automatically close the gap between e^* and $\underline{e}$ so that the black market of exchange rates should ideally vanish.

3. EMPIRICAL FINDINGS[6]

Given the above theoretical perspective we will pose two related empirical questions in this section. First, how exactly did the exchange rate react to these policy changes and hence, how many of these were necessary from the exchange rate's point of view alone. Table 1 and figure 2 summarizes the findings of a simple (dummy variable) structural break analysis on India's nominal rupee/US dollar exchange rate (see appendix 1 and 2 for the methodology and the detailed results). Since policies often take time to have their effects, we have calculated the instantaneous effects as well as effects after a lag of one period (month). It is obvious from the table that only devaluation and trade account convertibility had any significant (at 5% level) effect on the exchange rate. As expected the effect

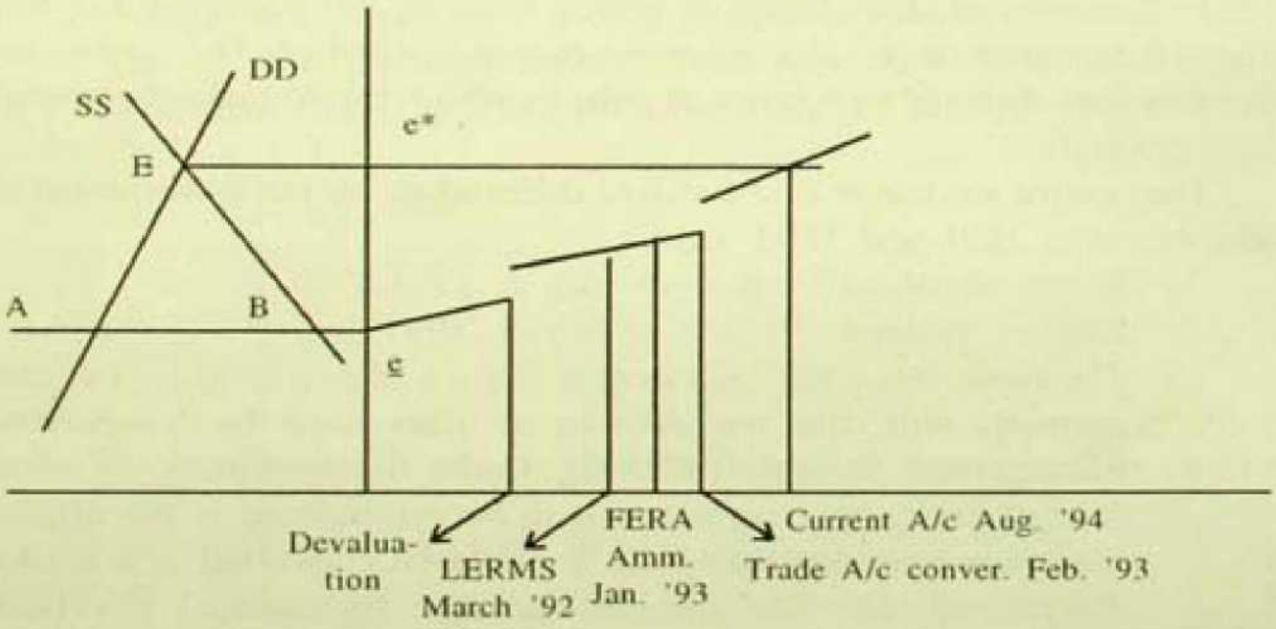

Figure 2

of devaluation was instantaneous. However the effect of trade account convertibility came after a lag of one month. This immediately implies two things. First that the government had successfully attained e^* with trade account convertibility and hence when the current account was finally made convertible there was no immediate jolt to the exchange rate. Secondly, initiation of the LERMS and amendment of FERA were

redundant policies as far as the exchange rate is concerned. Let us study each of these conclusions in turn.

TABLE 1
Structural break on India's Nominal (Rs./$) Exchange rate

Policy	Intercept[1]		Slope[3]	
	λ^1_0	λ^2_1	λ_0	λ_1
Devaluation	+	=	+	=
LERMS	=	=	=	=
FERA	=	=	=	=
Trade A/c convertibility	=	+	=	+
Current A/c convertibility	=	=	=	=

Notes : 1. λ_0 = Result without lag, 2. λ_1 = Result with one period lag, 3. '+' implies change at 5% level, '=' implies no change at the same level.

The empirical results as far as the policies that mattered are reported below. Turning first to devaluation we find:

$$NOM = 8.01 + .16\,t + 4.45\,ID_1$$
$$(5.9^*) \quad (9.4^*) \quad (9.02^*)$$
$$\bar{R}^2 = .99,\ F(3,115) = 9338.7^{*7}$$

and,

$$NOM = 9.31 + .14\,t + .058\,SD_1$$
$$(8.7^*) \quad (8.7^*) \quad (8.9^*)$$
$$\bar{R}^2 = .99,\ F(3,115) = 9310.2^{*8}$$

Where NOM is the Nominal (monthly) exchange rate, ID_1 and SD_1 are the intercept and slope dummies for devaluation (July 1991) and the figures in brackets are the t values[9]. The thing to note about the figures is that there has been a change both in intercept and slope. While the first finding is obvious, the second finding is not. Why was there a structural break in the slope? A harder look at the nominal exchange rate series reveals the following: the exchange rate was frequently adjusted with the basket of currencies in the pre devaluation period but no such adjustment took place in the immediate post devaluation period. Thus the exchange rate was virtually fixed immediately after the devaluation resulting in a significant decline in slope for the series. The structural break in slope is

a reflection of this fact[10]. As far as trade account convertibility is concerned, the results are as follows :

$$NOM = 6.97 + .17t + 4.85\ ID_{42}$$
$$(2.09^{*})\quad (5.3^{*})\quad (10.8^{*})$$

$$\bar{R}^2 = .99,\ F\ (3{,}115) = 10978.9^{**}$$ [11]

and,

$$NOM = 7.53 + .16t + .05\ SD_{42}$$
$$(1.75)\quad (3.9^{*})\quad (10.62^{*})$$

$$\bar{R}^2 = .99,\ F\ (3{,}115) = 10730.0^{**}$$ [12]

Where ID_{42} and SD_{42} are the intercept and slope dummies for trade account convertibility with one period lag. Here of course the change in slope is expected as the exchange rate is being subjected more to the vagaries of the market. An interesting point to note about the results is that the t values are larger for trade account convertibility than for devaluation.

Let us now turn to the case of the relative unimportance of current account convertibility and the importance of trade account convertibility. Table 2 shows India's overall balance of payments in the 1990s. It can be seen that (a) the net invisibles were positive (tending to exert a positive effect on the rupee) and (b) the absolute magnitude of net invisibles was only about one third the absolute value of net balance of trade. If we add

TABLE 2

India's Overall Balance of Payments in US Dollars

Item	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96
I. Merchandise						
A) Exports, f.o.b.	18477	18266	18869	22683	26855	32311
B) Imports, c.i.f.	27914	21064	24316	26739	35904	43670
Trade Balance (A-B)	-9437	-2798	-5447	-4056	-9049	-11359
II. Invisibles, net	-243	1620	1921	2898	5680	5449
III. Current Account (I+II)	-9680	-1178	-3526	-1158	-3369	-5910

Source : Hand book of Statistics on Indian Economy, Reserve Bank of India (2001)

to this the overwhelming importance of trade account transactions (exports and imports) relative to transactions in invisibles in the current account

the unimportance of current account convertibility seems to be an expected result. Of course, other factors (especially open market buying and selling of dollars by the Reserve Bank) may have played their role, but that is not obvious from the data.

While the relative unimportance of current account convertibility can be accounted for to a certain extent, the unimportance of LERMS is solely due to the fact that the exchange rate studied here is the official rate and not the market rate. It should however be noted that India's foreign exchange reserves had improved substantially (to about 10 billion dollars) by 1992-93 so that the Reserve Bank was perfectly capable of selling dollars in the open market to stop its slide if it so wished. In fact, the Reserve Bank has consistently intervened in the foreign exchange market in the post-float period to stabilise the rupee. The unimportance of FERA can be accounted for by the same set of arguments.

4. CONCLUSION

The Indian government took two major steps in making its currency fully convertible in the current account. First it switched on to the LERMS in March, 1992 which made the currency partially convertible. As a second step full convertibility was achieved in August, 1994. This paper suggests that none of these policies had any significant effect on the exchange rate. The exchange rate was on the other hand fully adjusted by the policies taken before them. The two policies crucial in this regard were the devaluation of July, 1991 and the trade account convertibility of February, 1993. Once these policies were undertaken the actual policy announcements were simply formal in nature. This suggests a system of good governance by the Reserve Bank of India and a proper sequencing of the policies so that exchange rate flexibility could be achieved with the minimum possible hurdle.

Appendix 1

Methodology of the structural break analysis

(See, for example, G.S. Maddala, *An Introduction to Econometrics*, pp. 306-315.)

I Break in Intercept :

Original equation :

$$X = \alpha_0 + \beta_0 T$$

Changed Equation :

$$X = \alpha_0 + \beta_0 T + (\alpha_1 - \alpha_0) D$$

Where $D = 0$ for $T < T^*$

$= 1$ for $T \geq T^*$ (T^* being the expected date of the break)

II Break in Slope :

Original equation :

$$X = \alpha_0 + \beta_0 T$$

Changed Equation :

$$X = \alpha_0 + \beta_0 T + (\beta_1 - \beta_0) DT$$

Where $D = 0$ for $T < T^*$

$= 1$ for $T \geq T^*$ (T^* being the expected date of the break)

III Simultaneous break in Intercept as well as slope :

Original equation :

$$X = \alpha_0 + \beta_0 T$$

Changed Equation :

$$X = \alpha_0 + \beta_0 T + (\alpha_1 - \alpha_0) D + (\beta_1 - \beta_0) DT$$

Where $D = 0$ for $T < T^*$

$= 1$ for $T \geq T^*$ (T^* being the expected date of the break)

Appendix 2

Detailed results for the structural breaks[13]

(Note : ID = Intercept dummy, SD = Slope dummy. Subscript 1 = devaluation, 2 = LERMS, 3 = FERA 4 = Trade account convertibility, 5 = Current account convertibility. Subscript 12 = One period lag and similarly for 22,32,42,52.)

1. $NOM = 8.01 + .16t + 4.45\ ID_1$

   $(5.9^*)\ (9.4^*)\ (9.02^*)$

   $\bar{R}^2 = 0.99,\ F(3,115) = 9338.7^*$

   Regression Method: CO (1): $U_t = 0.91\ U_{t-1} + e$ (27.9^*)

2. $NOM = 5.08 + .23t + 0.17\ ID_{12}$

   $(1.8)\ (7.0^*)\ (0.25)$

   $\bar{R}^2 = 0.99,\ F(3,115) = 5445.9^*$

   Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e$ (34.34^*)

3. $NOM = 9.31 + .14t + 0.058\ SD_1$

$(8.7^*)\ (8.7^*)\ (8.9^*)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 9310.2^*$

Regression Method: CO(1): $U_t = 0.89\ U_{t-1} + e\ (22.54^*)$

4. $NOM = 5.10 + .23t + 0.002\ SD_{12}$

$(1.7)\ (6.5^*)\ (0.19)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5444.5^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (33.69^*)$

5. $NOM = 4.72 + .23t - 0.18\ ID_2$

$(1.57)\ (6.9^*)\ (-0.28)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5446.7^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.26^*)$

6. $NOM = 4.77 + .23t - 0.14\ ID_{22}$

$(1.6)\ (6.9^*)\ (-0.22)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5445.2^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.20^*)$

7. $NOM = 4.63 + 0.23t - 0.002\ SD_2$

$(1.49)\ (6.6^*)\ (-0.33)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5448.1^*$

Regression Method: CO(1) : $U_t = 0.94\ U_{t-1} + e\ (36.19^*)$

8. $NOM = 4.69 + 0.23t - 0.002\ SD_{22}$

$(1.53)\ (6.7^*)\ (-0.26)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5446.3^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.12^*)$

9. $NOM = 4.79 + 0.23t - 0.11\ ID_3$

$(1.62)\ (7.05^*)\ (-0.18)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5444.3^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.38^*)$

10. $NOM = 4.75 + 0.23t - 0.16\ ID_{32}$

$(1.6)\quad (7.0^*)\quad (-0.25)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 5445.7^*$

Regression Method: $CO(1)$: $U_t = 0.94\ U_{t-1} + e\ (36.53^*)$

11. $NOM = 4.75 + 0.23t - 0.0013\ SD_3$

$(1.59)\quad (6.9^*)\quad (-0.20)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 5444.7^*$

Regression Method: $CO(1)$: $U_t = 0.94\ U_{t-1} + e\ (36.35^*)$

12. $NOM = 4.71 + 0.23t - 0.0017\ SD_{32}$

$(1.56)\quad (6.9^*)\quad (-0.26)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 5446.1^*$

Regression Method: $CO(1)$: $U_t = 0.94\ U_{t-1} + e\ (36.51^*)$

13. $NOM = 4.75 + 0.23t - 0.157\ ID_4$

$(1.6)\quad (7.04^*)\quad (-0.24)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115)\quad 5445.7^*$

Regression Method: $CO(1)$: $U_t = .94\ U_{t-L} + e\ (36.53^*)$

14. $NOM = 6.97 + 0.17t + 4.85\ ID_{42}$

$(2.09^*)\quad (5.3^*)\quad (10.8^*)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 10978.9^*$

Regression Method: $CO(1)$: $U_t = 0.96\ U_{t-1} + e\ (43.14^*)$

15. $NOM = 4.71 + 3.01t - 0.0017\ SD_4$

$(1.56)\quad (6.9^*)\quad (-0.26)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 5446.1^*$

Regression Method: $CO(1)$: $U_t = 0.94\ U_{t-1} + e\ (36.51^*)$

6. $NOM = 7.53 + 0.16t + 0.05\ SD_{42}$

$(1.75)\quad (3.9^*)\quad (10.62^*)$

$\bar{R}^2 = 0.99,\ F\ (3{,}115) = 10730.0^*$

Regression Method: $CO(1)$: $U_t = 0.97\ U_{t-1} + e\ (44.61^*)$

17. $NOM = 4.73 + 0.23t - 0.0033\ SD_5$

$(1.63)\ (7.3^*)\ (-0.597)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5459.8^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.22^*)$

18. $NOM = 4.74 + 0.23t - 0.36\ ID_5$

$(1.6)\ (7.3^*)\ (-0.57)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5458.5^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.21^*)$

19. $NOM = 4.81 + 0.23t - 0.227\ ID_{52}$

$(1.68)\ (7.32^*)\ (-0.35)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5448.9^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.17^*)$

20. $NOM = 4.73 + 0.23t - 0.0033\ SD_5$

$(1.63)\ (7.3^*)\ (-0.59)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5459.8^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.22^*)$

21. $NOM = 4.80 + 0.23t - 0.0021\ SD_{52}$

$(1.67)\ (7.3^*)\ (-0.378)$

$\bar{R}^2 = 0.99,\ F\ (3,115) = 5449.6^*$

Regression Method: CO(1): $U_t = 0.94\ U_{t-1} + e\ (36.17^*)$

NOTES

1. There was a period in 1971 when the rupee was pegged to the dollar rather than the sterling at Rs 7.5 to the dollar. The sterling peg returned from January 1972 and continued till September 1975. In June 1972 the sterling started to float so that the peg implied that the value of the rupee had to be kept stable with respect to the (floating) sterling.
2. As pointed out by a referee the word "equilibrium" should be treated with caution here. It should be clarified that under flexible exchange rates monetary authorities do not face a balance of payments problem. However in India, after the current account was fully freed, imbalance in the current account persisted implying thereby that the prevailing exchange rate, even after complete flexibility in the current account, was still not the true equilibrium exchange

rate. It was some version of what economists call the "dirty float". Several factors (such as, exchange rate volatility or a rise in capital mobility) can force governments to "manage" exchange rates. To see how the RBI has intervened in India's foreign exchange market in the post 1993 period, see, for example, Kohli (2000).

3. Since the econometric methodology of the paper is standard textbook material it is relegated to appendix 1. This will also help us to talk about the issue at hand without unnecessary interruptions.
4. I am indebted to Pabitra Giri for pointing this out to me.
5. See Siddiki (2002)
6. See Bratin Bhattacharyya, "Liberalization of India's foreign exchange and its impact on exports", A project submitted to the Department of Business Management, Calcutta University, 1996, for a similar analysis with slightly different conclusions. The exchange rate data has been taken from the *International Trade Statistics Yearbook* (various issues) published by the IMF.
7. Cochrane-Orcutt iterative method of order 1. The estimated residual equation is : $U_t = 0.91\ U_{t-1}t + \varepsilon_t$ (the figure in bracket is the t-value).
   (27.9^*)
8. $U_t = 0.89\ U_{t-1} + \varepsilon_t$
   (22.54^*)
9. Throughout this paper '*' implies that the relevant alternative hypothesis is accepted at the 5% level.
10. Fitting a regression equation for the pre and the post devaluation periods can easily determine this. The results are not reported here.
11. $U_t = 0.96\ U_{t-1} + \varepsilon_t$
    (43.14^*)
12. $U_t = 0.97\ U_{t-1} + \varepsilon_t$
    (44.61^*)
13. CO(1) = Cochrane Orcutt iterative procedure of order 1. '*' implies the alternative hypothesis is accepted at 5% level.

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RISK MANAGEMENT IN INDIAN BANKING— A NEW CHALLENGE

MALAY GUPTA

During the period from 1969 through 1991, the banking sector in India witnessed a phenomenal expansion both geographically and functionally. But this unparalleled expansion had certain inherent weaknesses. The public sector banks with a share in total business to the tune of about 90% were under a controlled regime. They lacked in functional autonomy and operational flexibility. As a result, important functional areas including deployment of funds, rates of interest on deposit and credit products, branch expansion and recruitment were administered. Emphasis on quantitative aspects of assets led to a marked deterioration in assets portfolio along with lower productivity, insufficient provisioning, inadequate accretion of reserves under capitalization and lack of transparency in accounting practices. Inadequacies of supervision, prevalence of old legal framework and lack of competitive spirit contributed to a banking structure which was not acceptable for global integration. Against this backdrop the liberalization of the economy and reforms in the financial sector including those in the banking sector in the 1990s have brought some challenges before the Indian banking system.

The financial sector reforms which were implemented following the recommendations of the Narasimham Committee in 1991 and subsequently the second set of measures implemented in 1998 after the recommendations of the Narasimham Committee attempted to increase / enhance the

(a) Financial strength of the bank (b) Bank's operational flexibility (c) Stricter supervision / corporate governance and (d) Competitive efficiency

The important measures to achieve the above objectives include:

A (i) Implementation of the basic norms relating to prudential accounting viz. asset classification, income recognition, provisioning and capital adequacy ratio.
(ii) Exposure norms for individual and group borrowers.
(iii) Transparency and disclosure norms.
(iv) Introduction of market risk weights for investment and credit.

B (i) De-regulation of rates of interest on deposits and credit / except Savings bank account.

(ii) Decrease in the statutory liquidity Ratio (SLR) and Cash Reserve Ratio (CRR).
(iii) Abolition of branch licensing.
(iv) More autonomy on deployment of credit.
(v) More discretionary power of the Board of Director.

C Introduction of stricter off-site and on- site supervisory system – Department of Supervision in the Reserve Bank of India (RBI).

D (i) Entry of new banks – liberalization regarding opening of offices by foreign banks.
(ii) Introduction of universal banking concept blurred distinction between banks and development financial institution (DFI).
(iii) Entry of banks to insurance sector.
(iv) Increase in the share of market capital–movement towards 33% shareholding by the Government of India/Reserve Bank of India in the case of public sector banks.

The steps initiated by the RBI and the Government of India as part of banking reforms had yielded positive results in the recovery of non-performing assets (NPA), increase in Capital Adequacy Ratio and profitability. A highly competitive environment has also been created along with technology upgradation on a wider scale of significance. The banks are now geared up to deal with the areas of risk management in a more effective way.

In a deregulated environment, when the domestic and international market are inter related, the long term viability and the continued success of a bank are critically dependent on an optimal enterprise-wide management of the risks inherent in all of its fields of business. The risk management is centered on the ability to identify, measure, aggregate and manage risks, to attribute capital and to price risks appropriately. The risk philosophy is based on the objective to maximize shareholders' returns within the framework of overall risk.

Even before initiation of the financial sector reforms Gerald Corrigan, President of Federal Reserve Bank of New York identified the elements of risk and its challenges[1]. He stated "important lesson of the 1980s is that the globalization, innovativeness and deregulation of financial markets have proved to be very much a two-edged sword. On the one hand, there is little doubt that these developments have expanded the choices for savers and investors, reduced the cost of financial transactions, improved the allocation of saving and investment nationally and internationally and increased the competitiveness and efficiency of financial institutions and financial markets. But, and this is a very large what, there is also no doubt-at least in my mind- that these same forces have also increased volatility in financial markets, introduced new and highly complex elements of risk-possibly even increasing systemic risk...."

The present paper makes an attempt to indicate the challenges before the Indian banks in this deregulated environment. Section II of this paper provides a sketch on the theoretical aspects of risk management. The risk management practice by some of the international banks have been shown in Section III while Section IV deals with the risk management practices of the Indian banks in general. The Basle New Capital Accord and the challenges to be faced by Indian Banks are outlined in Section V.

II

RISK MANAGEMENT-A BRIEF THEORETICAL FRAMEWORK :

It is known that Risk is defined as the portion of uncertainty which is measurable. In other words – "It is the loss that is expected to be incurred due to happening and non-happening of certain events/activities."

Risk management means :

Identification of source of risk, designing risk management policies, risk supervision and control mechanism.

The risk management is the key word of the core principles of the Basle Committee in 1997. According to the Committee "Banking, by its nature, entails taking a wide array of risks. Banking supervisors need to understand these risks and be satisfied that banks are adequately measuring and managing them". The core principles relating to risk management are:

BASLE CORE PRINCIPLES (Relating to Risk Management)

- Capital adequacy—the appropriate minimum capital adequacy requirements for all banks which should reflect the risks that the banks undertake.
- Credit granting standards and credit monitoring process.
- Assessment of asset quality and adequacy of loan loss provisions and reserves – Adherence to adequate policies, practice and procedures for evaluating the quality of assets and the adequacy of loan loss provision; and loan loss reserves.
- Concentrations of risk and large exposures—To identify concentrations within the portfolio – prudential limits to restrict bank exposure to single borrowers or groups of related borrowers.
- Connected lending - To prevent abuses arising from connected lending – specific limits and / or a specific capital charge on market risk exposures, if warranted.
- Other risk management – A comprehensive risk management process (involving appropriate Board and senior management) to identify, measure, monitor and control all other material risk and where appropriate, to hold capital against these risks.

- Internal controls – Clear arrangements for delegating authority and responsibility; separation of functions that involve committing the bank paying away its funds – Accounting of assets and liabilities, reconciliation of these processes; safeguarding its assets; and appropriate independent external or internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.

Principal Types of Risk[2]

Credit Risk: risk that deterioration in the financial condition of a borrower will cause to the asset value. This includes two other types of risks, namely country risks and settlement risks.

Market Risk: Includes market (product) liquidity risk and funding liquidity risk.

(a) Market (Product) Liquidity Risk : risk of losses incurred due to difficulty in accessing markets or products at the required time, price or volume.

(b) Funding Liquidity Risk : risk of the failure of the bank to settle at the settlement date or of the necessity of the bank to raise the funds at a higher rate than usual because of cash flow mismatches or unexpected fund outflows.

Operational Risk: risk relating to operating risk, system risk, compliance risk and other forms of associated risk.

Operating Risk: risk of losses arising from staff mistakes, negligence or fraud.

System Risk: risk of losses due to failure, damage or improper use of systems.

Compliance Risk: risk of losses arising from inadvertent or purposeful / wilful non-compliance with laws, regulations and guidelines.

Other Risks: risk of losses arising from damage to the Bank's reputation in the market or among customers, natural disasters, crime, civil disorder or resignation of skilled staff.

There is a wide gamut of literature on the risk management in banks enriched with various techniques and tools. An attempt is made here to present a simple algebraic formulation of credit risk and liquidity risk.

In a credit risk model if A be any asset, A will generate a series of repayments over time say $X(t)$ which is a random variable.

Again let the contractual repayment over time be represented by $C(t)$

So the deviation $Y(t) = X(t) - C(t)$ represents the loss.

Hence with any asset A there is an attached series of loss $Y(t)$ which are random variables.

Suppose for a given set of assets [A_1, A_2, ...An], there are loss variables ($Y_1(t)$, $Y_2(t)$, ..., Yn (t)}.

These may be combined to give the total loss $L(t) = L\ [Y_1(t), Y_2(t), \ldots\ldots]$

where L is a function of n variables.

[In most cases $L\ (t) = Y_1(t) + Y_2\ (t) + \ldots\ldots + Yn\ (t)$]

For a given set of assets there is thus an associated loss L(t) which is a random variable.

Again, the capital of the institution, say bank, denoted by K(t) at time t will depend on

(1) Profit /loss generated in the past,

(2) Fresh capital infusion,

If accumulated loss at time $T = AL(T) = \sum_{t \leq T} L(T)$

then $K(T) = K_0 - AL(T - 1)$

K_0 = Initial Capital

Hence K(t) also becomes a. random variable.

Therefore for a given set of assets we have a series of loss L(t) and capital K(t).

If Risk $= \alpha$

$= P[L_t \geq m\ K(t)]$ where $0 \geq m \geq 1$ and is determined by the manager.

$\alpha = \alpha(A_1, A_2, - - - -, m)$

Feasible Region F for $(A_1, A_2, - - - -)$ is defined by $[A_i \geq O,$

$\alpha \leq \alpha_0$, (given risk)

$\sum A_i \leq A^-$ (Size Constraint)]

For a given level of performance indicator at time t P(t) and for given (A) the problem is to maximize P(t) subject to F for a given á or minimize á subject to F.

Liquidity Risk (based on ALM Model- vide Section IV)

In the ALM model the exercise on Gap Analysis i.e Analysis of Structural Liquidity is carried out. On the basis of sectoral data of inflows and outflows the mismatch percentage is identified. The framework of summarized position is given below :

Bucket	1–14 days 1	15–28 days 2	29–3 months 3	3–6 months 4	6months– 1 year 5	1–3 years 6	3–5 years 7	Above 5 years 8
A. Outflow B. Inflow								
C. Mismatch (B – A) C/A (%)								

The bank examines whether the mismatch in liquidity with the tolerance limit as prescribed by the Controller or the Board of Director. While analysing the data (i) the roll over percentage, (ii) embedded option portions and (iii) the core portion of Savings deposits are considered. In can be expressed in the following fashion.

X = Outflows (Capital, Reserves and Surplus Deposits. Other liabilities and provision, of credit commitments, unavailed portion of cash credit /demand draft. etc, letter of credit, repos, bills rediscounted, swaps (Buy/sell) interest payable).

Y = Inflows (Cash, Balances with RBI, Balances without Banks, Investments, Advances (Performing), Non-performing assets, (Investments and Advances) Fixed Assets, other Assets, Reverse Reports, Swaps (Buy/Sell Interest Receivable, Committed Lines of Credit, Export Refinance)

Gi = mismatch in the i^{th} time bucket = $X_i - Y_i$

$$G = \sum_{i=1}^{n} G_i = \sum_{i=1}^{n} (X_i - Y_i)$$

$$\sum_{i=1}^{n} (X_i - Y_i) \leq K \quad K = \text{tolerance limit–given by the controller}$$

For each G_i there may be a tolerance level K_i.

In the next section we would discuss how the risk management principles are practiced by international banks on the basis of case studies on Deutsche Bank, Germany, Sumitomo Bank, Japan and Mizuhu Holding Inc. Japan.

III

RISK MANAGEMENT PRACTICES BY INTERNATIONAL BANKS : SOME CASE STUDIES

Deutsche Bank

Deutsche Bank stated that the Banks' risk management framework promotes an internal risk environment across the firm that is culturally attuned to its overall risk philosophy. Deutsche Bank manages risk through a comprehensive framework of risk principle, organizational structure and risk processes that are closely aligned with the activities of the Group Divisions.

The following five key principles are important according to the Bank in any approach to risk management.

- The management of credit, market, liquidity, operational and business risks is carried out in an integrated manner at all levels within the organization, since they are inseparable
- The risk management organization is closely aligned with the structure of the business divisions. (Figure I)
- The Risk management is functionally and organizationally independent of the group divisions.
- The Group Risk Board has enterprise wide responsibility for managing risks.
- The Group Board and the Supervisory Board will maintain their overall responsibility for Risk within the Group.

Sumitomo Bank

Sumitomo Bank recognizes risk management as the cornerstone of the Banks' operations and strikes a balance between "sound practices" and "profitability". Such equilibrium is achieved by first applying strike controls and limits and then maximizing the returns.

Since the modification of the Banks' governance structure in June 1999, the roles of the Board of Directors in the risk, management has been clearly defined, and the major principles of the risk management have been set up. The Bank established the Risk Management Committee within the Board of Directors. Risk management at Sumitomo Bank is governed by the following set of principles.

- Risk is to be managed on a consolidated basis.
- The relevant department and the individual business units are to be mutually checked.
- Risk is to be assessed on the basis of quantitative standards.
- Risk is to be managed by departments staffed with appropriately trained personnel and appropriately selected information systems.
- The implementation of the Bank 's risk management policies and procedures by the relevant departments as well as day to day business operations are to be subject to expert supervision and investigation of the independent internal audit departments.

Risk management at Sumitomo Bank is deemed to include credit risk, market risk, liquidity risk and operational risk.

At Sumitomo Bank, the process of decision making in risk management is as follows. The relevant departments are responsible for raising matters for discussion by the Management Committee. The Management Committee takes a decision on such items. This decision is then subject to review by the Risk Management Committee of the Board of Directors. Any final decision must then win the approval of the Board of Directors itself.

In Sumitomo Bank the Quantitative Measurement of Credit Risk is based on an asset value simulation. This computer model uses 10,000 simulations of the evolution of the Bank's asset value incorporating scenarios for loans, guarantees, bonds and other forms of exposure. Two types of risk indicators can be obtained from the result on the distribution of assets values based on these 10,000 stimulations. One is "Expected Loss" which shows the amount of risk generated on average. Earnings (also known as the "Credit Risk Premium") should be such as to permit the absorption of such risk. However, it also estimates the "Unexpected Loss", the second indicator. The Bank must hold sufficient capital to cover such unexpected losses and the amount of capital required for this is called "Credit Risk Capital".

The model for asset value simulation is shown in Figure II.

The Credit rating flow chart of Mizuho Holding Inc is also shown in Figure III.

India is a new entrant to this area. Steps taken by the Reserve Bank of India in implementing the Basle Core Principle relating to risk management have been indicated in the next section.

IV

Reserve Bank of India has already initiated steps for implementing the Basle Core Principles relating to risk management, potential regulations and requirements. According to the Reserve Bank the broad parameters of risk management function should encompass:

i) organizational structure;
ii) comprehensive risk measurement approach;
iii) risk management policies approved by the Board which should be consistent with the boarder business strategies, capital strength, management expertise and overall willingness to assume risk;
iv) guidelines and other parameters used to govern risk taking including detailed structure of prudential limits;
v) strong MIS for reporting, monitoring and controlling risks ;
vi) well laid down procedures, effective control and comprehensive risk reporting framework;
vii) Separate risk management framework independent of operational departments and with clear delineation of levels of responsibility for management of risk, and
viii) Periodical review and evaluation.

It may be found that the RBI is also following the same international practices as followed by some international banks.

In 1992 Capital Risk-weighted Assets Ratio (CRAR) was introduced which took into consideration the risks weights of different assets. Over

the years the norms evolved and started addressing the risk more and more comprehensively. Initially the Government approved securities had a risk weight of zero and similarly for Government guaranteed advances there was no market risk weight. Some of the recent norms regarding risk weights are given below :

- Investments in Government and other approved securities to carry risk weights of 2.5% From March 2000
- The risk weight of investment in Government guaranteed securities not part of the approved Government borrowing programme to carry risk weight of 20% on the outstanding stock as on 31.3.2002. in two phases.
- Risk weight for State Government guaranteed advances in default have also been introduced.
- Risk weight for open forex position is 100% effective 31.3.1999.

Assets and Liabilities Management (ALM) System

In a deregulated environment when the domestic and international markets are integrated, the Reserve Bank of India advises the banks to develop a comprehensive Asset-Liability management policy which addresses the following risks and forms integral part of a bank's business strategy.

Credit risk, Interest rate risk, Foreign Exchange risk, Equity/ Commodity price risk, Liquidity risk and Operational risk.

Asset-Liability management system rests on three pillars :

1. ALM Information System that will incorporate a management information system which is adequate, reliable and fast.
2. AL Organization aiming at developing the structure of hierarchy, delegation of responsibility and level of involvement of Top Management.
3. ALM process for identifying risks, designing methodology for measuring risks and defining risk environment by declaring risk policies and tolerance level.

The banks in India have already adopted the risk rating system and risk pricing of credit. In that system each risk factor viz credit risk, operative risk, counter party risk and market risk has been assigned a specific weight. The actual weight score by a borrower against each of the risk is assigned at a quarterly/half yearly interval. The score is summed up and on the basis of this score credit rating is allotted to each borrower. Accordingly risk rating is also indicated. Risk price is dependent on this risk rating.

Managing currency risk is one more dimension of ALM. Mismatch in currency position besides exposing the balance sheet to movements in

exchange rate also exposes it to country risk and/settlement risk. The banks have been given freedom to set gap limits with RBI's approval but are required to adopt Value at Risk (VaR) approach to measure the risk associated with forward exposures. Thus the open position limits together with the gap limits form the risk management approach to forex operations.

The Reserve Bank of India (RBI) in the draft guidelines (May 23, 2002) on Country Risk management by banks in India, has advised the banks to formulate appropriate and well documented and clearly defined Country Risk Policies. RBI has also asked bank boards to fix limits for their exposure to different countries by linking it to a percentage of the bank's own net worth and that countries should be classified within six risk categories and banks should make additional provisions for country risk, ranging from 0.25 percent to 20 percent of their exposure. The six risk categories are insignificant, low, moderate, high, very high and off credit.

In its draft guidelines on country risk exposure, the RBI said, in case of very weak economies, the central bank may fix prudential aggregate country exposure limit and while deciding exposures to countries, the banks may adopt sovereign ratings of international credit rating agencies. "However, banks should eventually put in place appropriate systems to move over to internal assessment of country risk within a prescribed period, say by March 31, 2004", RBI said.

While calculating their exposures, banks have to take into account their fund–based exposures as well as their non–fund exposures. In addition, the banks have been asked to consider indirect exposures such as loans given to a domestic borrower who has a large economic dependence on a certain country. However, banks have been allowed to calculate their exposures on a net basis, that is, by reducing from their gross exposures, collateral and guarantees from lower risk countries. The provisions set aside by banks for country risk will be treated at par with the provisions made by banks for standard assets for being reckoned for Tier II capital. The provision of the country risk shall be in addition to the provisions required to be held according to asset classification status of the asset. In case of loss assets and doubtful assets, provisions held, including provision held for country risk, shall not exceed 100 percent of the outstandings.

In this background Basle New Accord has added a new dimension in the area of risk management practices by the Indian Bank. The major feature of this New Accord is shown in the next section.

V

BASLE NEW ACCORD

In the international area, new developments are taking place. The new Basle Accord on capital adequacy of the Basle Committee on Banking Supervision released in January 2001 would replace the 1988 Accord. The committee is expected to finalize the Accord in 2002. An implementation date of 2005 is envisaged.

The committee has emphasized three pillars of the new framework, namely minimum capital requirements, a supervisory review process and effective use of market discipline.

The new Accord would attempt to develop a risk sensitive framework that contains a range of new options for measuring both credit and operational risk.

It also envisages to align capital standards very close to the risk profile of various counter parties. Accordingly preferential risk weight on various counter parties would be assigned on the basis of their underlying credit qualities.

The banks should have a process for assessing their overall capital in relation to their risk profile and a strategy for maintaining capital. The new accord proposes two approaches for calculating risk weighted assets viz. Standardized Approach and Internal Rating Based Approach to estimate regulatory capital. In Internal Rating Based Approach there are two approaches Foundation Approach and Advance Approach. Banks which would comply with certain requirements would be allowed to use their own estimates of probability of default (PD) associated with the borrower in each of the internal credit rating grades.

The regulators will be setting rules for estimating the value of loss given default (LGD) and unrealized portion of exposure at default (EAD).

Under the advanced approach, banks would be allowed to use their own estimates of PD, LGD, EAD- to be validated by the supervisory authority.

Under both approaches, risk weights are to be expressed as a single continuous function of PD, LGD and EAD.

Under the standardized approach, preferential risk weights in the range of 0%, 20%, 50%, 100% and 150% would be assigned on the basis of external credit assessments. Banks have been advised to study the Basle framework on capital for market risk and to prepare themselves to follow the international practices in this regard.

In the announcement of credit policy (2002-03), the Governor, Reserve Bank of India, indicated that the Committee received over 200 responses from national supervisors, banks, international institutions, and other experts. It has also been stated such a wide variety of comments

indicate the fact that achieving global consensus on the methodology of capital regulation is not an easy task. Many respondents have expressed their concern at the difficulties that would be experienced in implementing their proposals on accounts of their complexity and cost. RBI is also engaged in developing suitable modified approach within the philosophical framework of the Basle proposals which could be adopted to the Indian situation and simpler to implement and supervise. Further assigning risk weight for bank assets should largely be a matter for the banks or their supervisors.

CONCLUSION

The financial sector reforms introduced in the early ninetees have left a perceptible impact on banking sector. The implementation of the Narasimham Committee recommendations (1991, 1998) was a step towards sounder banking with emphasis on de-regulation, liberalization and globalization. In a regulated and controlled regime most of the decision making parameters were given from above. As a result, the banks' risk management policies had a very limited role. But after liberalization, the banks in India are made to familiarize themselves with the challenges of risk management. Various techniques are used by them and organizational structure is changed to cope with the challenge of identifying, managing, monitoring and controlling the risk. When Basle New Accord is going to be implemented it brings newer challenges before the banks. Banks can face those only through development of human resources by way of imparting required training and technological up gradation suited to the banks of the 21st Century.

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FIGURE-I
DEUTSCHE BANK

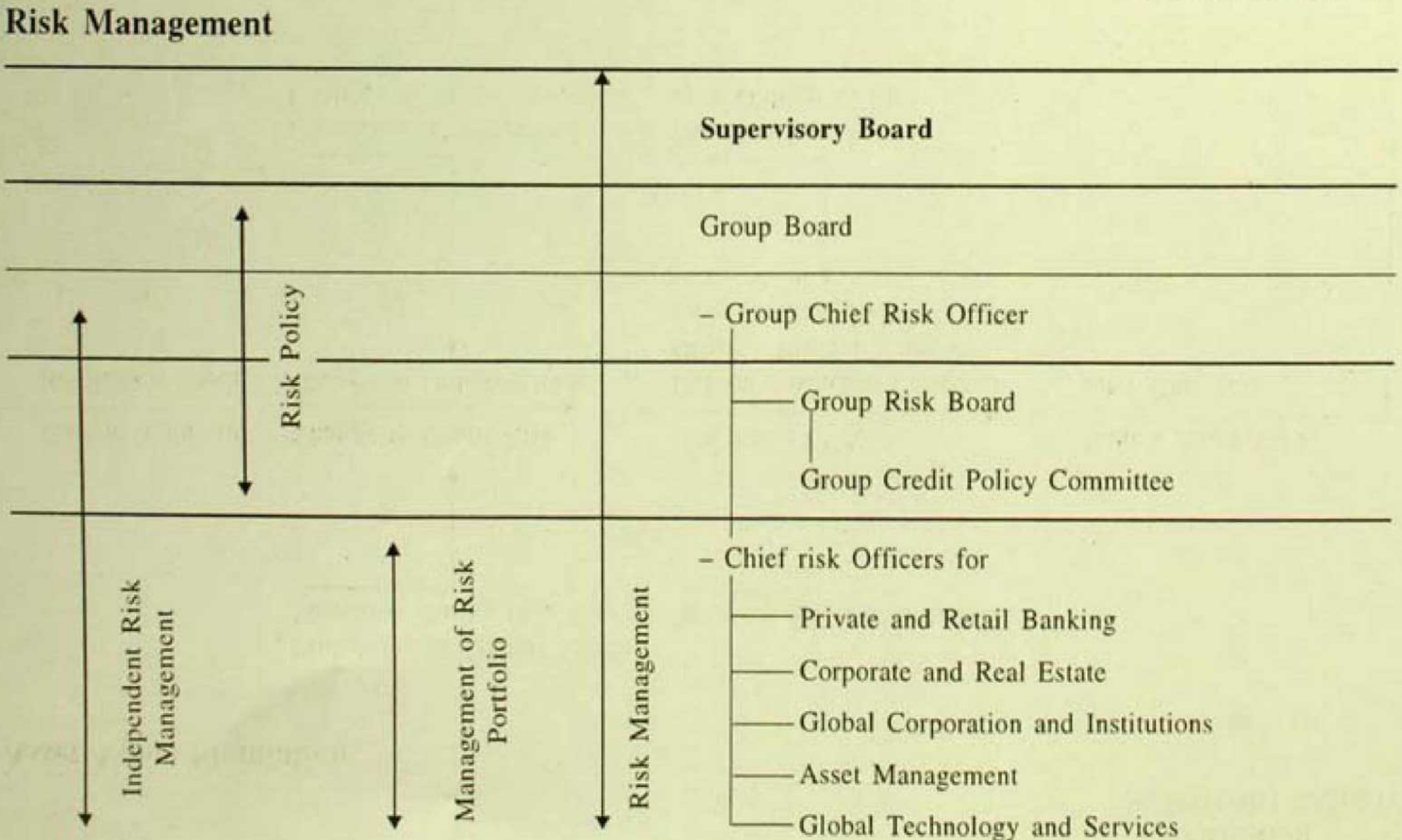


FIGURE-II
SUMITOMO BANK

Asset Value Simulation

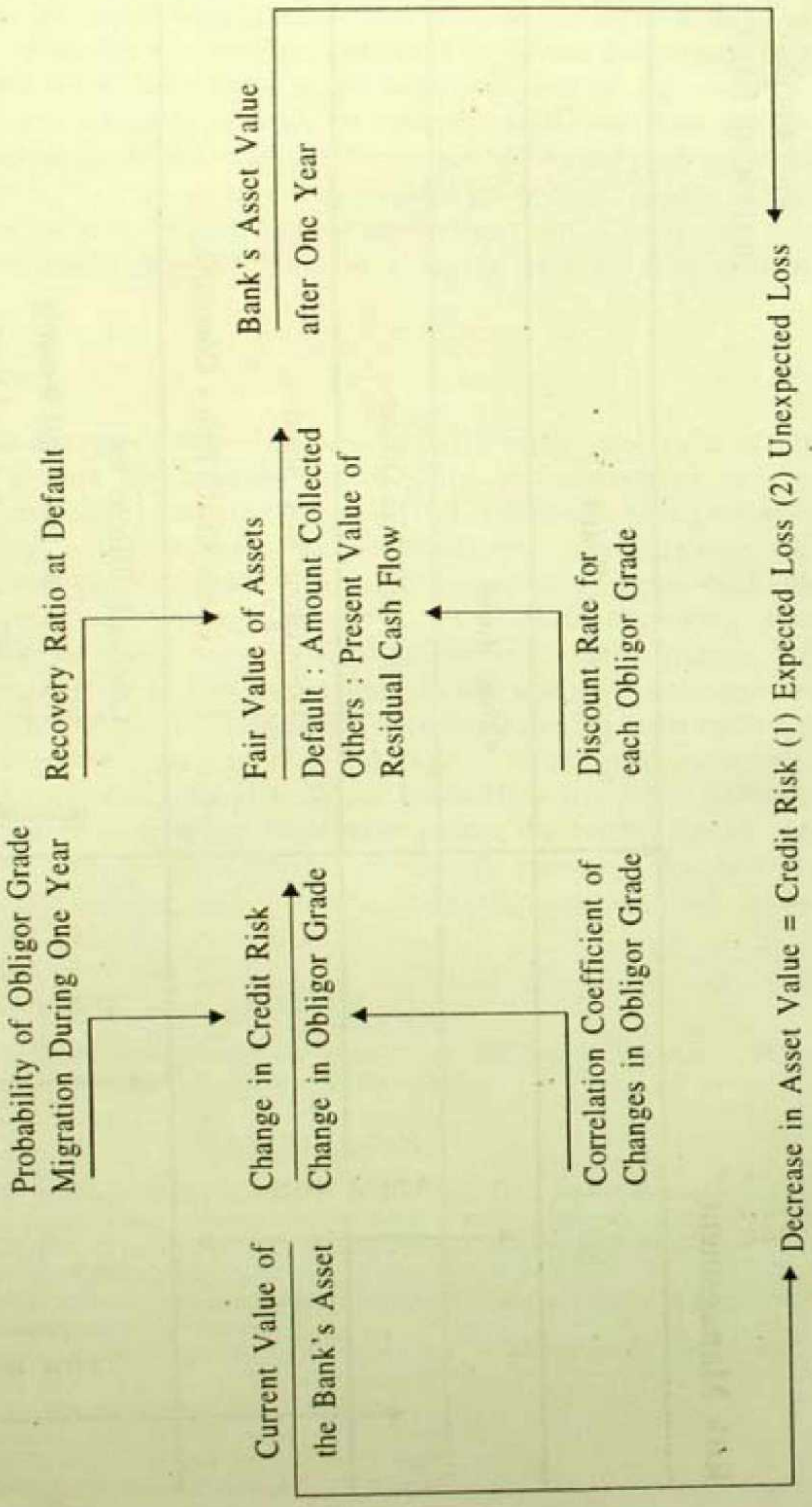
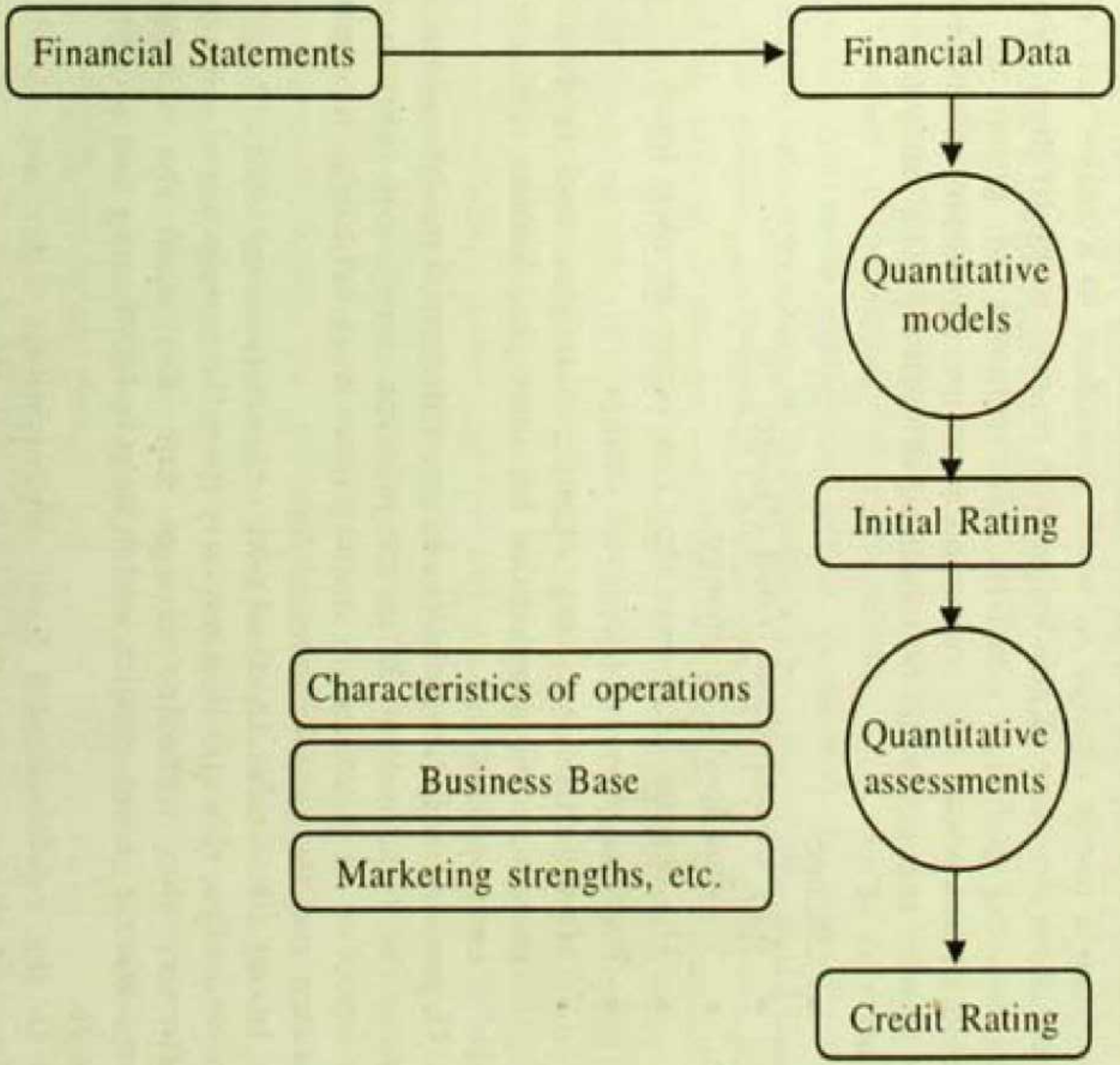


FIGURE-III

Credit Rating Flowchart



Source : Mizusho Holdings, the Annual Report 2000-01

MANAGING SOME ASPECTS OF HUMAN RESOURCES IN TIMES OF CHANGE

RAJIB DASGUPTA

Change is a fact of life in all organisations. Changes in organisations vary from a minor change in work procedure to a major revamping of organisation structure. Knowledge with respect to motivation, leadership, organisational politics, conflicts, determinants of group as well as individual behaviour and communication are important in understanding how change processes can be managed effectively. The study tries to make an analysis of :

- Change
- Why organisations need change
- Various levels of change
- The degree of change that can occur in each level
- Explore why people resist change
- Models for analysing change strategies and in this context provide some suggestions for managing human resource in this environment.

Organisational change refers to any substantial modifications in some parts of the organisation. In actual practice change can involve virtually any aspect of an organisation starting from work schedules to organisation structure and the people themselves.

In our effort to understand why organisations do need change we will have to analyse this question not only from the standpoint of environmental parameters that influence change but also from the standpoint of organisational characteristics which help in facilitating and accepting such change.

In the environmental front organisations today are faced with a barrage of change agents that put them in the back foot with respect to their long term strategies. They need to revise them on a continuous basis in order to stay abreast with the competition. Change by itself suggests transition. In this regard we are talking of change in the environment in which the organisations operate. Change per se can occur in every sphere of the environment. The major reasons that are instrumental in bringing change in organisations may be summed up as follows :

External Factors :

- Globalisation
- Rise of knowledge worker and the urge to protect intellectual property in the competitive environment
- Changing role of women in the society
- Fast changing technology, shorter technology life-cycle
- Social consciousness for depleting natural resources asking for new adjustments
- Changing needs of society, individual taste and preferences

Internal Factors (organisation specific) :

- Diversification
- Restructuring of departments and job process
- Change in the ownership and control

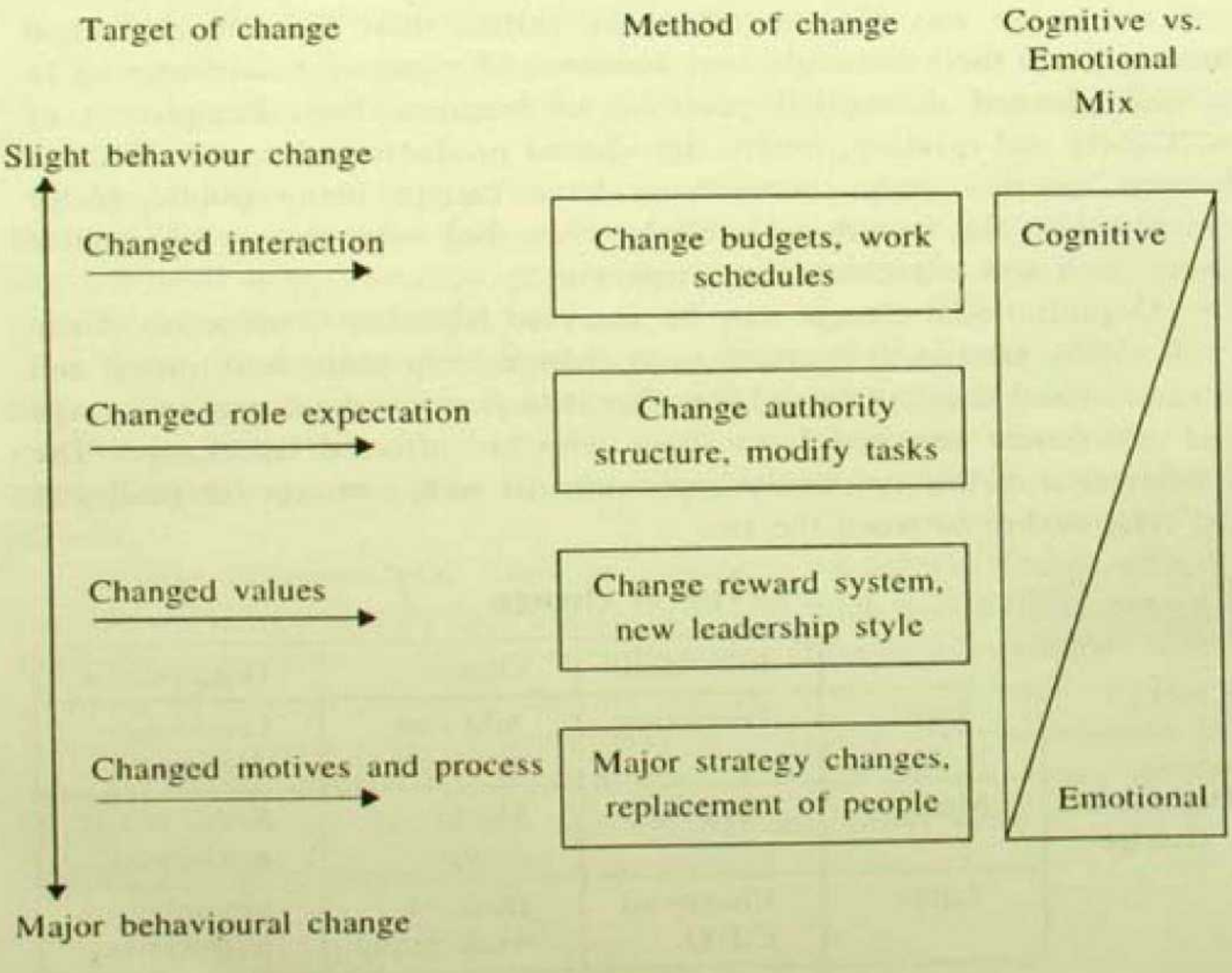
Organisations need change in order to survive in this dynamic environment. Some organisations go through a process of **planned change** in a proactive manner anticipating the changes in the future, while other organisations undergo a process of **reactive change** in response to the circumstances as they develop. A general case in this context may be referred to the way ITC in India have shifted their focus in a planned manner from their erstwhile core business of cigarette manufacturing to a well planned diversified portfolio of business lines comprising of packaging and printing, hotels, agro-based products and so on. While a hurried reaction under compulsion have caught many public sector organisations flat-footed, particularly when they were forced to compete in an open and unprotected environment.

Organisational change may be analysed from two standpoints (Gray et al 1988). One is to measure such change from individual, group and organisational standpoints and the other is to examine the degree of change and adjustment required from those who are affected by change. The combination of this two analysis provides us with a matrix for analysing the relationship between the two.

Levels of change

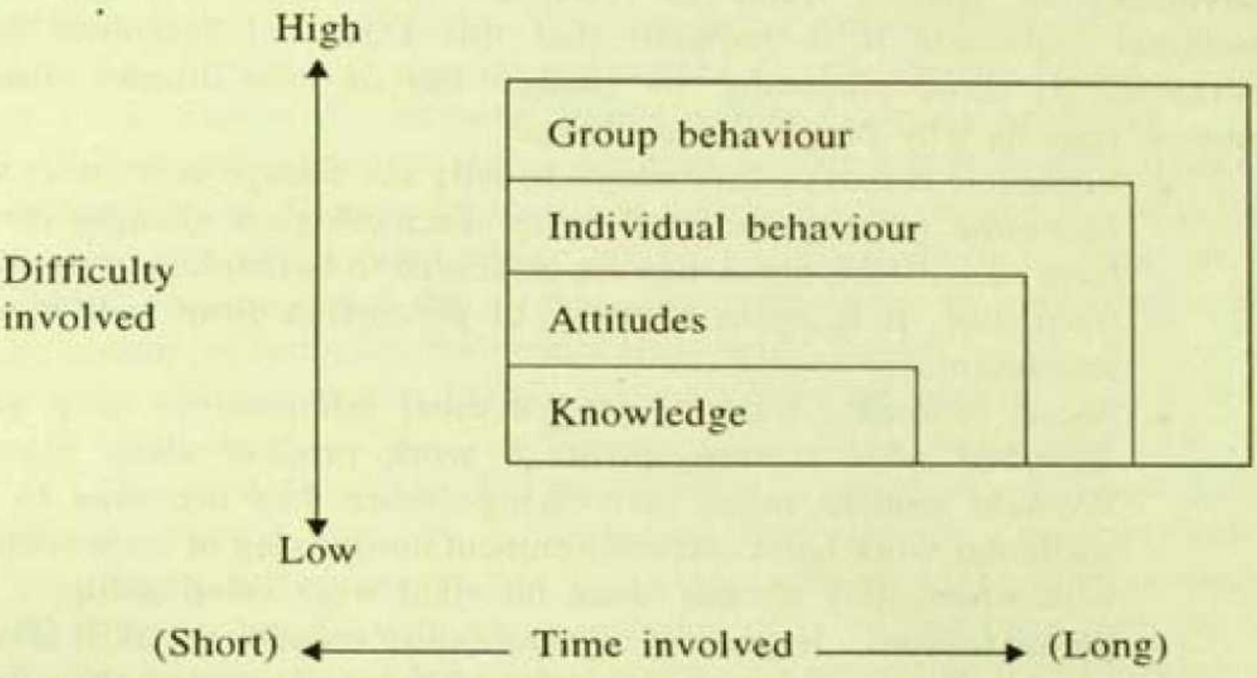
		Individual	Group	Organisation
Degrees of change	Small	Promotion	Add new employee	Create new department
	Medium	Training	Merge groups	Reduction in workforce
	Large	Change of C.E.O.	Disband work group	Major restructuring

Changes at individual level seldom have any significant impact on the entire organisation. Although in some situation it does leave a significant impact on the overall performance of the organisation where the change of C.E.O. of the organisation may bring about a total change in the organisation culture and revolutionise the work habits within the organisation. Such change may act as a driving force behind a major restructuring process. A change at group level however is significantly important since most works within the organisation are organised on a group basis. Group factors are to be taken into consideration since both informal as well as formal groups may be instrumental in resisting change. Change at organisational level is referred to as organisational development. Changes at this level involve major restructuring process that affects both individuals and groups. These changes take place in a phased manner and require considerable planning for implementation. Changes can occur at various degrees at any level (Lawrence et al 1969). There can be large changes at individual level or small changes at organisational level. The range of change vary according to the degree of change required, the length of time required to implement the change and the level of cognitive versus emotional content of the change.



A similar analysis made by Hersey and Blanchard (Hersey et al 1972) shows how different levels of change compare on the basis of difficulty and time involved. These changes require changes in expe ience through positive reinforcement over extended period of time.

Time and difficulty involved in making various changes:



RESISTANCE TO CHANGE AND MANAGING SUCH RESISTANCE

It is widely publicised that employees or people by nature resist change. Therefore we tend to characterise people as 'antichange', whereas, in fact they are the most adaptable creatures on earth. Accepting the fact that people have a natural instinct to adapt to their environment is the first step toward effective management of change. It puts employees or people in a more positive light and suggests that change is an unnatural behaviour and therefore the result of the situation rather than a built-in response to a change. Changes have both rational and emotional implication as already discussed. Similarly resistance to change can have both emotional and rational sources. Various studies have documented the fact that the psychological and sociological factors operating in organisations produce resistance that cannot be related to the objective data. Rational resistance to change occurs when people do not have the proper level of knowledge or information to evaluate the change. The resistance in this respect is such that providing the necessary information about the change reduces the resistance. Emotional resistance to change involves psychological prob-

lems of fear, anxiety, suspicion, insecurity, etc. These feelings develop because of people's perception of how the change will affect them. The personal nature of perception, emotional resistance is often difficult for others to understand. Management may initiate an action that would truly benefit the employee but such an action may not be appreciated in equal terms because of emotional blocks. Change is always viewed from an individual's or group's frame of reference, and while dealing with emotional resistance it is required that this frame of reference be understood by those proposing the change. Let us now discuss some common reasons why people resist change.

- Economic reasons : Individuals usually see change as a threat to economic security and well-being. Technological changes may have such effects since they are perceived to be displacing people from jobs. It is again a matter of perception from individual standpoint.
- Social reasons : Existing interpersonal relationships may get disturbed once rearrangement of work process takes place. Workers tend to resist such change since they are used to a particular work habit and environment comprising of co-workers with whom they already share informal work relationship.
- Status reasons : In general mechanisation reduces the skill level in jobs thereby reducing the status of those occupying the jobs. Any change in the office automation and the work process is bound have its impact on the status of the concerned employee. While in certain case the status upliftment may take place, in other situation changes may reduce the status level of the concerned employee with respect to the other.
- Security reasons : It has been observed that individuals by nature look for structure and predictability. The existence of the security blanket causes individuals to resist change because of the uncertainty associated with such change.
- Skill and competence reasons : Changes that reduce the skill and competence requirement of employees are often resisted. In this case just like status such resistances emerge out of the ego need.
- The "path of least resistance" reason : It is sometime observed that change as change is simply resisted because there are no additional incentives to go along with it. People prefer to remain in status quo since change does not make their lives any better.

MODELS THAT HELP IN MANAGING AND IMPLEMENTING CHANGE.

Force-Field analysis

This is a unique technique first conceptualised by Kurt Lewin. This technique describes and analyses the various forces that operate in social systems to keep the system either in balance or in a state of change. He proposed two sets of forces that operate in the environment:

- Forces that operate for change i.e. the driving forces
- Forces that operate against change i.e. resisting forces.

If at any point two forces are found to be equal, then the system is in equilibrium. Change by means of increasing the driving forces is likely to give rise to a 'coiled spring effect' (Herbert, 1976). Therefore it is always recommended that organisations should try to implement change by means of reducing the forces that resist change.

In addition to this Lewin also provided the model:

Unfreezing ⟶ Change ⟶ Refreezing

This model suggests that organisation in the process of implementing change should first try to unfreeze the existing predispositions in employees concerning change, implement change, make them understand the change process with an open frame of mind and once they get used to the change refreeze the change process by cementing it and making such change permanent and operational. This method by far is considered to be the most painless process of implementing change. This probably drives home the point that change is inevitable and the best way to do so is by getting everyone to be a part of the process.

Contingency model or framework by Kotter and Schlesinger (Kotter et al 1979) presents six possible methods for dealing with resistance to change. The various approaches are :

- Education and communication : This is a method where adequate and accurate information is provided to the employees.
- Participation and involvement : This is a method where the affected people are allowed to participate in the process and are allowed to have a voice in the process and the methodology of how change will occur. Introducing better work environment with proper leader behaviour taking care of both the task dimension as well as employee relationship helps in enjoying trust and confidence of the coworkers.
- Facilitation and support : Providing training for change. Proper counselling and facilitation with respect to the emotional

reactions to change. In this regard sensitivity training or t-group training is very useful.

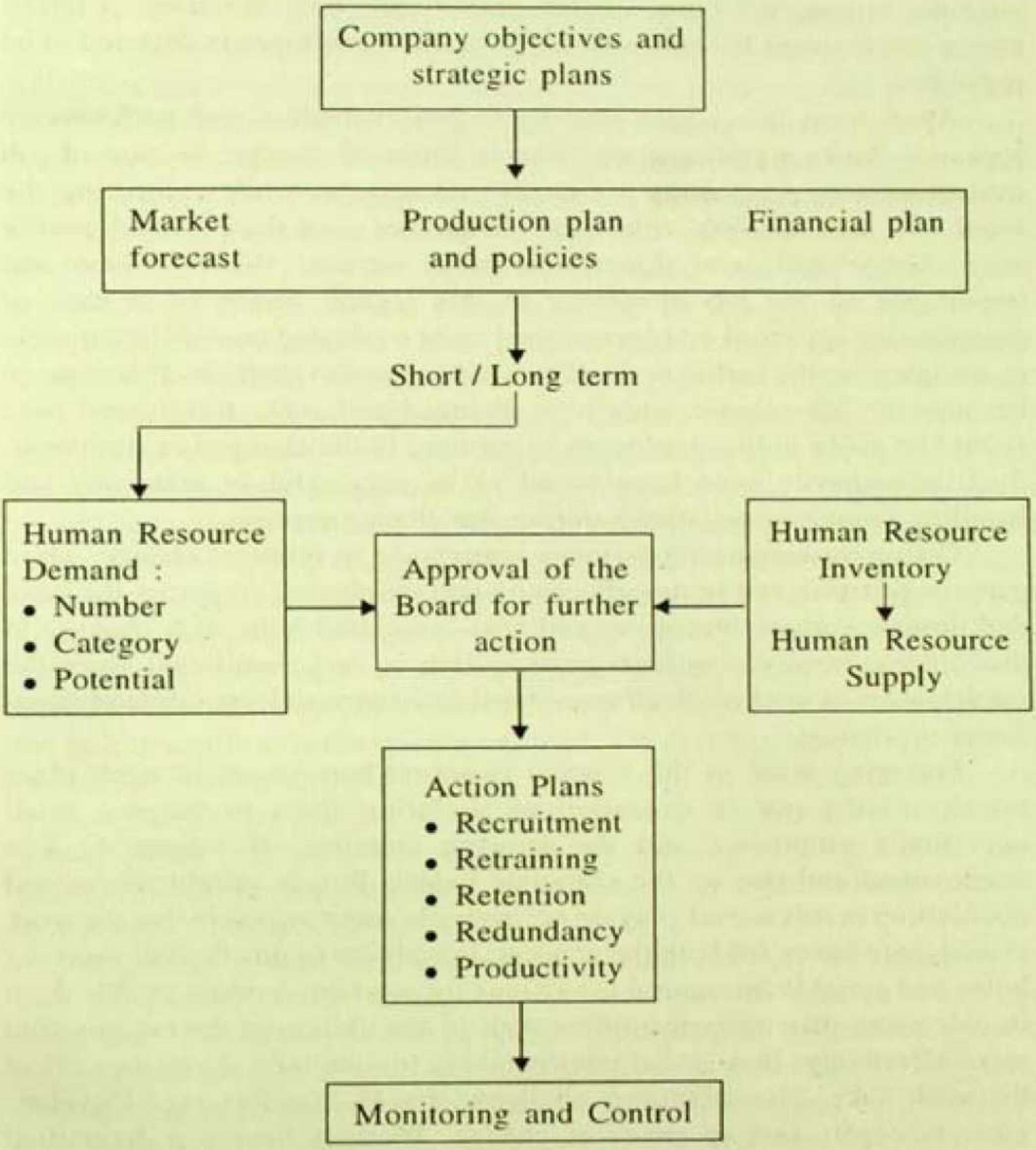
- Negotiation and agreement : Bargaining over various aspects of change. Making trade-off to accommodate concerns of those affected. Trade-offs take place in the form of job enrichment, additional incentives to go along with additional responsibilities.
- Survey feedback : This refers to a system whereby a survey about the employee reactions regarding possible changes help an organisation to adopt a suitable approach towards initiating change and ensure organisational development.
- Manipulation and co-optation : This is a process in which information about change is used selectively, or seconding a representative from the group to participate in the design of the change.
- Explicit and implicit coercion : using power position and threats to force compliance

Apart from the methods mentioned above organisations in changing environment also form a habit of making change a norm, a habit that one gets used to. Thus when change is accepted as a practice, it creates less flutter and noise. Introducing multiple changes at any given point of time also spreads the resistance over those changes.

Managing human resource in this changing environment therefore become significant. With change new problems within the organisations emerge particularly those resulting from creation of surplus labour as well as equal opportunity. One has to keep in context the ethical and social dimensions while suggesting ways and means of managing these problems. It has been found that majority of the organisations in their quest for quick short term return tries to overlook the social dimensions of these problems and try to solve them with the easiest possible solution, i.e. operate the unwanted fat in the waistline and make your appearance presentable or implement legal compulsions for behaviour. It therefore become necessary to look for an alternative, where some ways may be thought of to solve these problems exclusively from social and ethical standpoint.

Let us now look into a model that tries to provide an insight into the manpower planning process exercised by various organisations in order to cope with the change, streamline their operations and optimise the manpower in keeping with modernisation of technology and other restructuring and diversification plans.

Manpower Planning Process



Manpower planning process in times of change is executed according to the requirements based upon the supply of human resource that the existing inventory within the organisation can provide. In this case the inventory refers to the surplus labour that results out of technological upgradation that reduces the contribution of manual labour. Hence on a continuous time frame employee contribution to the overall job profile need to be evaluated to assess the productivity – incentive equilibrium and keep record of the numbers in the inventory. A manageable inventory calls for appropriate rehabilitation of employees through proper training since

retrenchment is socially damaging to the image of the institution. However once the inventory become unmanageable unfriendly decisions of terminating employment become necessary once the employee is declared to be redundant.

Apart from this issues relating to job evaluation and performance appraisal draws significant attention in times of change. In case of job evaluation new parameters are taken into account while comparing the worth of a particular job with respect to another since the entire job profile may change and new dimensions may increase the relevance and importance of the job altogether in this regard. Similarly in case of performance appraisal employees need to be evaluated on a different scale as compared to the earlier scale of comparison and evaluation. This is again because the job requirements have changed and some transitional time should be given to the employees to get used to the changed environment. Such adjustments have been found to be successful in managing and handling employee resistance during the change process.

Collective bargaining assumes importance in times of change. Third party negotiation and trade-offs ensure that employees sit across the table and discuss various incentives and cost associated with such change. In this context however workers participation is very significant since the participation of workers itself ensure less resistance and smooth implementation of change.

Emerging issue in this context is sexual harassment in work place mainly arising out of organisations declaring them to become equal opportunity employers and the growing ambition of women to join employment and rise up the corporate ladder. Proper enlightenment and counselling in this regard is again necessary in order to ensure that the work place is safe haven for both the genders. In addition to this flexible working hours and suitable intramural provisions for working mothers enable them in delivering their responsibilities both to the child and the organisation more effectively. In a global environment cross-cultural diversities affect the work force. This is another challenge that Human Resource Development managers face in times of change. Workers having a diversified economic, social and ethnic background create problems in standardising human resource policies in an organisation. It is therefore required that such issues are individually taken up and solved based upon the merit of each case.

It is important to note here that many organisations off late have resorted to the high-handed strategy of announcing employees as redundant in their effort to become lean and thin whenever it became difficult for them to counter difficult times. This strategy was employed with success primarily owing to the labour reforms that most world economies have

undertaken in the post WTO environment. Although this provides enough leverage to the employers to exercise flexibility it deprives the employee from enjoying the security of the work in terms of stable work tenure. Therefore one should not forget the ethical dimensions of social parameters whereby strategies should be devised to create an environment where employers should try to visualise and apprehend changes owing to short technology life and changing social norms. It should remain committed in terms of rehabilitating the existing employees even in difficult times while at the same time carry on to maximise wealth and add value to the organisations. New business avenues should be thought off and investments should be made in those projects that carry good prospects of profitability. In this context it is always preferable that a company undergoes a process of planned change thereby causing less pain to the employees undergoing through the process of change. However in the event of unforeseen calamities it is recommended that the organisations should show some restraint in terms of implementing their high-handed attitude. In developing economies where primarily the conversion of labour intensive to capital intensive technologies have taken place a large amount of surplus manpower has been put into the retiring blocks by force. This could easily have been avoided through better foresight and different attitude towards investment. It is said in the management world today that the best investment is the investment made for developing and upgradation of human resource skill and potential. This equips an organisation to handle change much more peacefully and in a very effective manner. Stimulating a sense of an inbuilt culture within an organisation to grow and develop continuously provides the necessary impetus to an organisation to nurture and groom : *Intraprenuers.*

Once this is done new avenues for investment may be hunted down and the painful act of laying off workers may to a large extent be controlled. The studies of a large number of organisations across the world suggest that benefit of such an exercise did pay dividends in long term and the shocks of short term cost factors are well absorbed by the returns brought in by such investment opportunities. 3M, Du pont, Sony, are some examples in the block.

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HUMAN RESOURCE MANAGEMENT IN A TOTAL QUALITY ENVIRONMENT

DHRUBARANJAN DANDAPAT

Management of an organisation has never been an easy task. But economic liberalisation, in recent times, has resulted in opening up of the economy to the global market, which in turn, has created an unfathomable competition in the corporate world. The organisations are striving for their very survival in this competitive era. Therefore, managing organisations in this new competitive environment is now more complex and sophisticated — 'perhaps today there is no other latest activity which is as important and dynamic as management — the oldest of arts and newest of profession' (Basu, 1979).

Every business organisation usually employs three principal resources — Physical (Materials and Machines), Financial (Money) and Human (Men). However, 'in the management of 4Ms — Materials, Machines, Money and Men — it is needless to belabour the obvious piont that, considering the nature of man, the management of men' is not only fundamental but also dynamic and challenging (Rudrabasavaraj, 1979). It may be mentioned that human resource is the only resource that competitors cannot copy, and is the only resource that can synergise, i.e., produce output whose value is greater than the sum of its parts. Therefore, it is quite obvious that the business organisations depend greatly for its effective functioning, not so much on its financial capital or physical assets, as on its team of efficient and motivated workforce. Moreover, human resource, in recent times, has assumed considerable importance particularly due to increasing dominance of *service* and *knowledge based* organisations where people play the pivotal role in the success of such organisations.

Going through the historical development of different management approaches, it may be found that Taylor's *Scientific Management* drastically improved productivity but failed to recognise the importance of an organisation's most important and valuable asset — the *knowledge and creativity of the workforce*. However, afterwards, *Hawthorne Experiment* of Elton Mayo and others; the works of Abraham Maslow, Douglas Mcgregor, Frederick Herzberg and others helped develop the concepts of motivation, leadership, employee development, individual and group approaches to job design with an emphasis on *human relations*. Moreover, the concept of *Total Quality Management* (TQM), which has been being

operationalised almost globally since 1980s after its successful and effective implementation in Japan, recognises the contribution of human resources toward developing a competitive edge. W.E.Deming (1986), the well known quality expert, emphasises that no organisation can survive without good people, people who are improving.

Reich (1987) writes, 'the skills and insights of a nation's workforce, and the quality of its transportation and communications links to the world (its infrastructure), are what make it unique, and uniquely attractive, in the new world economy ...... A workforce possessing a good basic education, which can efficiently bring the fruits of its labors to the global economy, can attract global capital for its performance of moderately complex tasks....'. Three important elements of human resources are *skill, ability and knowledge*. Though some inherent factors may control skill and ability of a person, there is no denying the fact that these may be improved and made effective through *continuous education and training* i.e., improving knowledge-base —one of the areas where much emphasis is given in TQM. Therefore, HRM is an essential element of TQM. In this paper, an attempt has been made to focus on HRM processes within the context of TQM covering the following sections :

- Concepts of Human Resource (HR), Human Resource Management (HRM), Quality, Total Quality and Total Quality Management (TQM)
- New dimensions of HRM in a TQM environment
- Teamwork, Empowerment and Motivation in HRM for achieving higher quality
- Concluding observations

CONCEPTS

This paper, as stated earlier, attempts to highlight the new dimensions of HRM in a *Total Quality Environment*. Therefore, it is considered essential to discuss, in brief, the concepts of *Human Resource, Human Resource Management, Quality, Total Quality and Total Quality Management* in order to build up the framework for discussing the issues involved.

Human Resource (HR), in this context, may be viewed as the total knowledge, skills, creative abilities, talents and aptitudes of an organization's workforce, as well as the value, attitudes and beliefs of the individuals involved (Megginson, 1977). Therefore, resourcefulness of various categories of people—managers, R&D people, executives, supervisors, workers and all such people available for the organization— can be treated as HR.

Human Resource Management (HRM) is the process of managing the people of an organization with a *humane* approach. It is a system that focuses on human resources development and effective management of people so that people may enjoy human dignity in their employment. HRM becomes a part and parcel of every manager's job (as everyone of them has to manage his/her own departmental people), while the *human resource manager* must act as a catalyst and exemplar, who directs all the aspects of managing manpower, human resources development, counselling, industrial relations, welfare activities, and so on.

HRM is a modern term for what has been traditionally referred to as 'Personnel Management'. Traditionally, the role of a personnel manager was limited to interview and selection of employees, negotiation with the labour union, keep time cards on hourly workers, and occasionally teach a training course. But, overtime, their role has changed dramatically. Now they are usually involved in determining organisation's human resource needs; selecting and recruiting, developing, counselling and rewarding employees; acting as a liason with unions and government organisations; and handling other matters of employee well-being.

Therefore, HRM today may be viewed as planning, organising, controlling and developing the potentials of employees and motivating the HR to give their best effort in order to achieve the target of *zero defect* by *doing things right first time* and striving for continuous improvement of the products/services for satisfying the customers and deriving a sustainable competitive advantage. Major distinction between Personnel Management and HRM is shown in Figure 1.

FIGURE 1

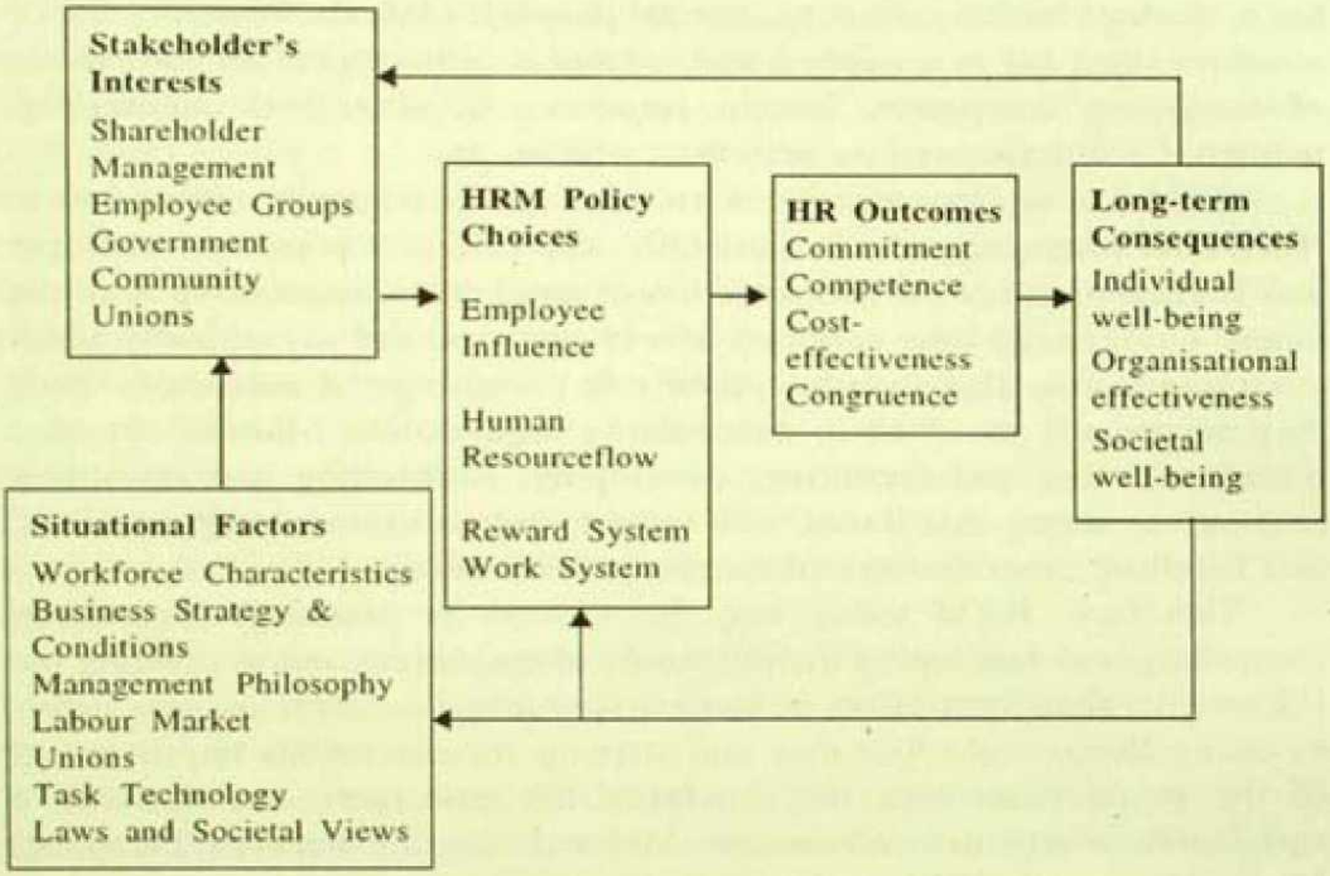
Major Distinction Between Personnel Management (PM) & HRM

PM	HRM
Management of *People Involved*	Management of *employee's skills, knowledge, abilities, talents, aptitudes, creativity*, etc.
Employee is viewed as a commodity	Employee is treated as *resource*
Employees are treated as Cost Centre and therefore, Management controls the cost of labour	Employees are treated as Profit Centre, and therefore, invests capital for HR development and future utility

In recent times, HRM is viewed as a change or development driven by fundamental environment changes (particularly in product market

conditions) which were not capable of being adequately responded to by the traditional concerns, orientations and power of personnel management functions. The modern approach to HRM is shown in figure 2.

FIGURE 2



Source : *Beer, Spector, et al.* 1984

The approach represents, in many respects, a departure from previous views of the nature and purpose of personnel management and, in essence, offers a set of prescriptions for managers to connect the effective management of HR with corporate success and broader positive consequences for society (Hollinshead and Mikeleat, 1995).

So far as the term **Quality** is concerned, there are different approaches advocated by different quality experts. Some of them are noted below.

- *superiority or innate excellence* — transcendent definition.
- *a precise and measurable variable and that difference in quality reflects difference in quantity of some product attribute* — product-based definition.
- *quality is determined by customers' wants or needs and his/her intention/willingness to pay for it,* which leads to a user-based definition – *fitness for intended use.*
- *conformance to specifications* — manufacturing- based definition.

- a *quality product is one that provides performance at an acceptable price or conformance at an acceptable cost* — value-based definition.
- *quality is meeting or exceeding customers' expectations* — modern view.

However, the most widely used and accepted definitions of quality are *fitness for use* (Juran, 1988) and *conformance to requirements* (Crosby, 1979).

Total Quality (TQ) is referred to as a people focussed management system that aims at continual increase in customer satisfaction at continually lower cost. TQ is a total system approach and an integral part of high level strategy. It works horizontally across functions and departments, involving all employees, top to bottom, and extends backwards and forwards to include the supply chain and customer chain.

Total Quality Management (TQM) is a continuous process of improvement for individuals, groups of people and total organization. TQM is about changing the way things are done within the organization's life-time. People, must know what to do, how to do, and have the right methods to do it, and be able to measure the improvement of the process and the current level of achievement in order to improve the process. Traditionally, the art of management is getting the ideas out of the heads of bosses into the hands of labour. But TQM aims at mobilising and putting together the intellectual resources of all employees in the service of the organisation.

TQM focuses on quality leadership vis-à-vis competitive advantage which may be achieved following the principles, as proposed by Scholtes (1988), mentioned below:

- *Customer Focus*
- *Obsession with quality*
- *Recognising the structure in work*
- *Freedom from control*
- *Unity of purpose*
- *Looking for faults in the system*
- *Teamwork*
- *Continued education and training.*

Customer is at the hub of TQM concept. TQM recognises that *quality is the driving force* for all organisational activities and it is concerning everyone — the managers and the other employees. *Recognising the structure in the work* require that leaders support and empower employees to investigate, analyse, and improve methods for doing work in a systematic manner. *Everyone* should strive for the same goals. It is the common experience that majority (85%, according to Deming) of the

quality problems are due to the fault of the system. Therefore, *managers should not attempt to affix blame* on *individuals for fault*, rather they should encourage suggestions for necessary corrections in the system. Managers must encourage developing *teamwork* delegating authority and responsibility for teams to make decisions and suggestions for improvement that will result in higher quality. Moreover, *continued education, training and motivation* is required to make the best use of human resources available in the organisation for achieving quality leadership, and thereby, deriving sustainable competitive advantage.

TQM is an integrative management concept which emphasises on continuous improvement of quality of products /services, in order to satisfy the customers, involving everyone in the organisation. The success of TQM greatly depends on effective utilisation of the *human resources*. The ultimate object of TQM is to supply the customers *defect-free* innovative products/services not merely to satisfy but even to exceed the customers' expectation. To accomplish such objectives, the investment in system/ process development will not be enough *unless the employees are properly trained and motivated to do the job* ***right first time***.

NEW DIMENSIONS OF HRM IN A TOTAL QUALITY ENVIRONMENT

Human Resource managers are now required to consider and plan for development of the organisation's corporate culture, as well as routine operations involved with the maintenance of HRM systems. If the organisation is committed to adopt a TQM philosophy, both the process and content of the HR department — the way it carries out its mission and responsibilities — will be drastically changed.

The TQM focus is changing the role of HRM by changing the perspectives of employees, HRM professionals, and line-and-staff managers from adversarial, control-oriented relationship to a co-operative position based on mutual organisational and individual goals, trust and respect.

Traditionally, HRM philosophy of *a fair day's work for a fair day's pay* was the driving force in many industries. Productivity and profits, were given priority while quality objective was to meet the minimum required standard. Managers' and shareholders' (owners) interest were considered most, while employees and customers were last in priority. Education and training were basically job-related, rewards were driven by productivity ignoring quality aspects.

In contrast, HRM in TQM environment is expected to develop a more co-operative, productive, flexible and innovative work environment. This

approach is based on recognising the value of human resource in meeting customer needs, with a focus on sharing information, responsibility and rewards. The transformation of HRM from *traditional* to ΓQM may be represented in Figure 3.

FIGURE 3
HRM/TQM Vs. Traditional HRM

	HRM/TQM	TRADITIONAL HRM
PHILOSOPHY :	Shared Responsibility, Commitment	Fair day's Work and Rewards for a Fair day's Pay
BUSINESS OBJECTIVES:	Focus on Customers' Satisfaction through Increased Quality, Productivity & Employee Satisfaction	Focus on Increased Productivity & Profitability
QUALITY OBJECTIVE :	Achieving Total Quality and Improving Quality continually is Everybody's concern	Maintenance of Quality is the Responsibility of Quality Control Dept.
MAJOR CONSTITUENCIES	Customers, All Employees & Shareholers	Managers, Shareholders Employees & Customers
EMPLOYEE INVOLVEMENT	Extensive— within and between Levels and Functions	Programmes–Suggestion Plans, Individual Emplyee Awards, Usually no Formal System
EDUCATION & TRAINING	Continuous	Need-based

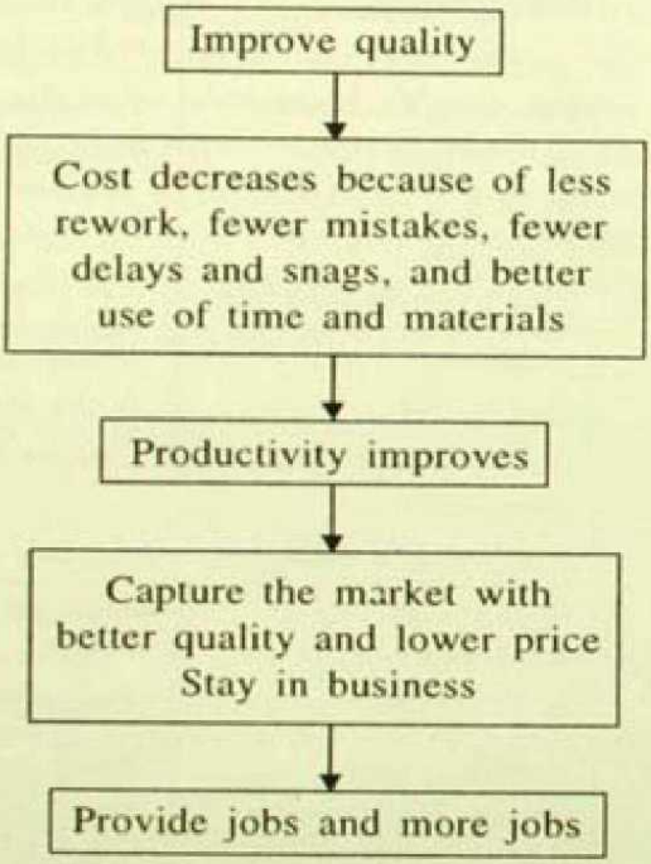
Source : *Adapted from Carla O'Dell, Sharing the Productivity Payoff, 1986.*

The above figure clearly shows that the TQM approach has brought about significant changes in business philosophy and objectives, expectations of the stakeholders, and attitude towards the employees. Traditionally, objectives of the business organisations were predominantly directed towards productivity and profits. Consequently, customers and employees were given low priority; workers participation in management programmes were limited to offering suggestions by the employees; training and

development programmes were limited to job related activities rather than enhancing employee capabilities. But, in a total quality environment, HRM approach is directed towards maximising customer satisfaction and market share through improved quality.

The effect of quality improvement activities through effective utilisation of human resource may clearly be represented by the Deming Chain Reaction, shown in figure 4.

FIGURE 4
The Deming Chain Reaction



Higher quality may lead to higher productivity because of fewer interruptions, defects, etc. Higher productivity has a favourable impact on cost and hence on profitability, other things being constant. It may be argued that when quality is improved in a creative way, cost is reduced and productivity is increased. Quality can be a cause of reduction in cost and increase in productivity, but low cost and/or high productivity do not always lead to quality improvement. Therefore, logically, an organisation must start with quality whenever an attempt is made to improve its performance.

Importance of HRM in TQM can be easily demonstrated with reference to the famous Deming's Fourteen Points for Management (Deming, 1986), which many organisations have used for years in course of their quality journey. The fourteen points are listed below.

Deming's *Fourteen Points* for Management

1. *Create constancy of purpose for improvement of product and service*
2. *Adopt the new philosophy*
3. *Cease dependence on mass inspection*
4. *End the practice of awarding business on the price tag alone*
5. *Improve constantly and forever the system of production and service*
6. *Institute training*
7. *Teach and institute leadership*
8. *Drive out fear, create trust, create a climate for innovation*
9. *Break down barriers between staff areas*
10. *Eliminate slogans, exhortations, and targets for the work force*
11. *Eliminate numerical quotas: a) Eliminate numerical quotas for production, instead learn and institute methods for improvement. b) Eliminate M.B.O., instead learn the capabilities of process and how to improve them. A person fulfils his/her quota at any cost to maintain his/her job without having regard to the quality of the job or any damage to the organisation. So the quota system should be eliminated.*
12. *Remove barriers that rob people of pride of workmanship*
13. *Institute a vigorous program of education and retraining*
14. *Take action to accomplish the transformation*

It may be observed that eight points (6—13) out of these fourteen points, listed above, are directly related to HRM.

Further, HR Focus is one of the most important considerations for the Malcom Baldrige National Quality Award (MBNQA), the most prestigious US National Quality Award. Other aspects which are considered for this award are leadership, strategic planning, customer and market focus, information and analysis, and process management. The requirements of MBNQA with respect to HR Focus (Appendix 1) reveals that an organisation has to build up an HRM system that will help harness the full potential of its human resources by providing them an appropriate organisational climate, effective education and training, and looking into employee well-being, satisfaction, motivation, etc.

TEAMWORK, EMPOWERMENT AND MOTIVATION IN HRM FOR HIGHER QUALITY

Effective *teamwork* is a central facet of TQM. A team is a small number of people with complementary skills who are committed to a common purpose, set of performance goals, and approach for which they

hold themselves mutually accountable (Katzenback and Doglas, 1993). Teamwork enables various parts of the organisation to work together in meeting customer needs that is very difficult to be fulfilled by employees individually, working in isolation. The total quality philosophy recognises the interdependence of various parts of the organisation and uses teams as a way to coordinate work.

Teams are actually a sub-set of the organisational behaviour / social psychology concept of groups. All teams are groups, but not all groups are teams. A group refers to a number of persons who communicate with one another often over a span of time, and who are few enough in number that each person may communicate with all others (Homans, 1959). Some groups may be more cohesive or productive than others and some may support or undermine organisational goals, but a team is formed for working together to achieve a goal.

Managers need understand why people do and do not join teams. People participate on teams for many reasons (Jaycox, 1996) :

- They want to be progressive in making decisions that affect their work.
- They believe that being involved in teams will enhance their potential for promotion or other job opportunities.
- They believe that teams will be privy to information that typically is not available to individuals.
- They enjoy the feeling of accomplishment and believe that teams provide greater possibilities.
- They want to use team meetings to address personal agendas.
- They are genuinely concerned about the future of the organization and feel a sense of Obligation to help improve it.
- They enjoy the recognition and rewards associated with team activity.
- They find teams to be a comfortable social environment.

On the other hand, many people refuse to join teams for reasons such as outside commitments, fear of embarrassment, mistrust of management, fear of failure or losing one's job, etc.

True leaders need to develop strategies for dealing with these issues.

Empowerment means giving someone power, i.e., granting authority to do whatever is necessary. By empowering employees, organisations drive decision making down to its lowest possible level.

Empowerment is an application of the teamwork principle to total quality, embodying 'vertical' teamwork between managerial and non-managerial personnel (Evans and Dean, 2000). It represents a high degree of involvement in which employees make decisions themselves and are responsible for their outcomes.

For empowerment to occur managers must undertake two major initiatives (Conger and Kanungo, 1988) :

- identify and change organisational conditions that make people powerless, and
- increase people's confidence that their efforts to accomplish something important will be successful.

Although empowerment is relevant for all aspects of organisational performance, it plays an important role in quality improvement. Five of the Deming's Fourteen Points for Management (Point Numbers 6, 7, 8, 10 and 13), stated earlier, relate directly to the notion of empowerment. According to Juran (1989), 'ideally, quality control should be delegated to the workforce to the maximum extent possible'. However, empowerment must be done sincerely, not superficially. Dan Ciampa (1991) says, 'simply bringing employees together once a month and exhorting them to work harder to achieve the business's objectives is not enough. A process is needed that enables them to make significant improvements in their own work area that help meet the business imperatives in a way that will satisfy the needs of the individual employee'.

Quality depends to a great extent on employee commitment at every level of the organisation. If employees are not provided with the proper motivating climate to exert their efforts to meet organisational goals, the result can be conflict, poor performance, and low quality levels. Therefore, to attain higher quality of products or services, the **motivation** of employees is indispensable — which involves not only eliminating human dissatisfiers, but also providing human satisfiers. Managers need to understand that there is no such thing as an unmotivated employee.

The various well known theories of motivation may be grouped into *Content Models* (describe how and why people are motivated to work) and *Process Models* (tend to focus on the dynamic process of how people make choices in an effort to obtain desired rewards). Three of the popular content models are: Hierarchy of Needs Model (Maslow, 1943 & 1954), Motivation Maintenance Model (Herzberg, et al, 1959) and Theory X and Theory Y Model (McGregor, 1960). On the other hand, Reinforcement Theory (Skinner, 1953), also known as Operant Conditioning, Preference-expectancy Theory (Vroom, 1964) and Contingency Model (Porter and Lawler, 1968) are widely known process models.

The Hackman and Oldham (1980) Model help to explain the motivational properties of task design by tieing together technical and human components of a job. Quality is related, in one way or the other, to all the five core job characteristics (task significance, task identity, skill variety, autonomy and feedback from the job) of this model. Because, quality of a product/service may certainly be improved by a worker's

dedicated application of skill, enhanced by task identity and a feeling of task significance. Moreover, quality of work is enriched by a task design that incorporates autonomy and feedback relating to quality characteristics. The expected outcome is high job satisfaction and high work effectiveness leading to high quality.

CONCLUSION

There has been significant change of managerial attitude towards workers. The *Industrial Revolution,* with its emphasis on mass production, viewed workers as *hired hands* and they were expected to perform like sophisticated machines against proper wages. By the 1970s, people began to think about quality of work life and, as a result, more attention was given to the feelings, attitudes and commitment of workers. Concept of QCs brought to light that workers have ideas and they could identify and solve the problems effectively. As a natural consequence, workers were gradually made involved more and more in the planning process. With the growing recognition of employees' competence, enlightened organisations nowadays try to confer on their employees as much power as possible to achieve the objectives.

Finally, it should be appreciated that management of human resources is not the function/responsibility of the personnel/human resource manager alone. Essentially, all the managers relating to different functions/ departments — purchase, production, finance, marketing, etc., — have to manage the people of their own functions/departments. Hence, all of them must unavoidably have to perform the role of a personnel/human resource manager in developing skill, ability and knowledge of the human resources under their control. In this sense, HRM is an all-pervasive concept concerning every function, every manager and every individual in an organisation. Therefore, effective and efficient utilisation of every individual in an organisation is the core objective of HRM as well as one of the most important prerequisites to the successful implementation of TQM.

APPENDIX 1
Key Management Practices reflected in the 1999 Malcolm Baldrige Quality Award Criteria

Human Resource Focus (Evans and Dean, 2000)

- How the organisation designs, organises, and manages work and jobs to promote cooperation and collaboration, individual initiative, innovation, and flexibility, and to keep current with business needs.

- How managers and supervisors encourage and motivate employees to develop and utilise their full potential.
- How the employee performance management system, including feedback to employees, supports high performance.
- How compensation, recognition, and related reward/incentive practices reinforce high performance.
- How the organisation ensures effective communication, cooperation, and knowledge/skill sharing across work units, functions, and locations.
- How the organisation identifies characteristics and skills needed by potential employees, and recruits and hires new employees, taking into account key performance requirements, diversity of the community, and fair workforce practices.
- How education and training approaches balance short- and longer-term organisational and employee needs, including development, learning, and career progression.
- How education and training are designed to keep current with business and individual needs.
- How the organisation seeks and uses input from employees and their supervisors/managers on education and training needs, expectations, and design.
- How the organisation delivers and evaluates education and training.
- How the organisation addresses key developmental and training needs, including diversity training, management/leadership development, new employee orientation, and safety.
- How the organisation addresses performance excellence in its education and training, and how employees learn to use performance measurements, performance standards, skill standards, performance improvement, quality control methods, and benchmarking.
- How the organisation reinforces knowledge and skills on the job.
- How the organisation addresses and improves workplace health, safety, and ergonomic factors and how employees take part in identifying these factors and in improving workplace safety, including performance measures and/or targets for each key environmental factor and significant differences, if any, based on different work environments for employee groups and/or work units.
- How the organisation enhances employees' work climate via services, benefits, and policies, and how these enhancements are selected and tailored to the needs of different categories and types of employees, and to individuals.
- How the work climate considers and supports the needs of a diverse workforce.

- How the organisation determines the key factors that affect employee well-being, satisfaction, and motivation.
- How the organisation conducts assessments to understand employee well-being, satisfaction, and motivation, and tailors the methods and measures to a diverse workforce and to different categories and types of employees.
- How the organisation relates assessment findings to key business results to identify work environment and employee support climate improvement priorities.

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HUMAN RESOURCE MANAGEMENT : AN ACCOUNTANT'S PERCEPTION

MALAYENDU SAHA

INTRODUCTION

It is now become a widely held premise that human resources provide organisations with an important source of sustainable competitive advantage which can be achieved through facilitating the development of competencies that are firm specific and generate tacit organisational knowledge. Corporate entities, the world over, have increasingly become aware of the importance of human resources. Actually, the strength of an organisation is very much depended on the quality of human resources it possesses. Akio Morita, the founder of Sony Corporation, once said, "there is no 'magic' in the success of Japanese companies in general and Sony in particular. The secret of their success is simply the way they treat their employees." According to him the human resources are the most valuable constituent of an organisation and it is they who serve the organisation with their work, talent, creativity, and drive. As such, human resources should no longer be treated as cost centres or system supporters, rather they are the real value drivers. The competition in the twenty-first century will favour only those entities that possess these wisdom and competent employees. Human dynamics also play a pivotal role in surmounting obstacles, defusing complex situations and achieving organisational goals. It is man which acts as catalyst, thoroughly motivated and absolutely dedicated, and keeps the company's profit curve soaring upwards. Vedvyas in the Mahabharata extolled: 'nothing is superior to human being'. Peter Drucker lamented, 'an organisation is like a time; it is not constituted by individual sounds but by their synthesis'. The success of an organisation depends entirely on the cohesive performance of man and machine and the qualities of products and services offered by them.

Human resource management encompasses the activities designed to provide, motivate and co-ordinate the human resources of an organisation. The adoption of sophisticated human resource management policies and practices is seen as one of the major keys to competitive advantage in the modern world. Michael Porter suggested that human resource management could help a firm attain competitive advantage by lowering costs, by

increasing the sources of products and services differentiation, or by both. As such, integration of business strategy with human resource strategy is vital for organisational success as the later not only serves attaining organisational objectives but also grows up as a key resource for competitive advantage.

Traditionally, the various assets like land and building, plant and machinery, inventories and monetary claims are considered as resources of an entity. But they themselves cannot generate goods and services. It is men with the help of whom these assets can be operated. In fact, human resources are the catalysts of the production process. However, value of such human resources is not conventionally reported in the financial statements. Even the expenses incurred for the selection, recruitment and training with a view to developing such resources for deriving services from them are neither capitalised nor amortised in the books of accounts. These have led to the development of the concept of human resource accounting. The concept refers to the process of identifying and measuring human resources and communicating this information to interested parties.

In this article attempts are made to focus on the accounting aspects on human resource management and to analyse how this concept helps the organisation in managing the most valuable asset to achieve its desired objective.

HUMAN RESOURCE MANAGEMENT AND CORPORATE STRATEGY

The organisations, all over the world, are passing through excessive competitions and are adopting various strategies to attain larger customer base and success. The evolving nature of organisations due to failures, downsizing, mergers and acquisitions, the expanding service sector, changes in organisational culture and climate, and challenges of maintaining organisational productivity to stay in this competitive environment call for better strategic planning of human resources. Competition necessitates improvement of the quality of products, reduction in cost to make the price competitive, innovation in product development and enhancement of productivity leading to achieving corporate excellence. This requires a workforce who is trained, motivated, goal-oriented, and committed. Moreover, continuous development processes need to be evolved to grow, develop and excel. This is high time that corporate managers have started developing a strong organisational culture towards achieving the corporate excellence.

Corporate excellence is the combination of people, system, product and marketing excellence. Out of these people excellence is the pivotal factor as it has an overall direct bearing on the system, product and marketing. The following are the important human resource issues in achieving corporate excellence :

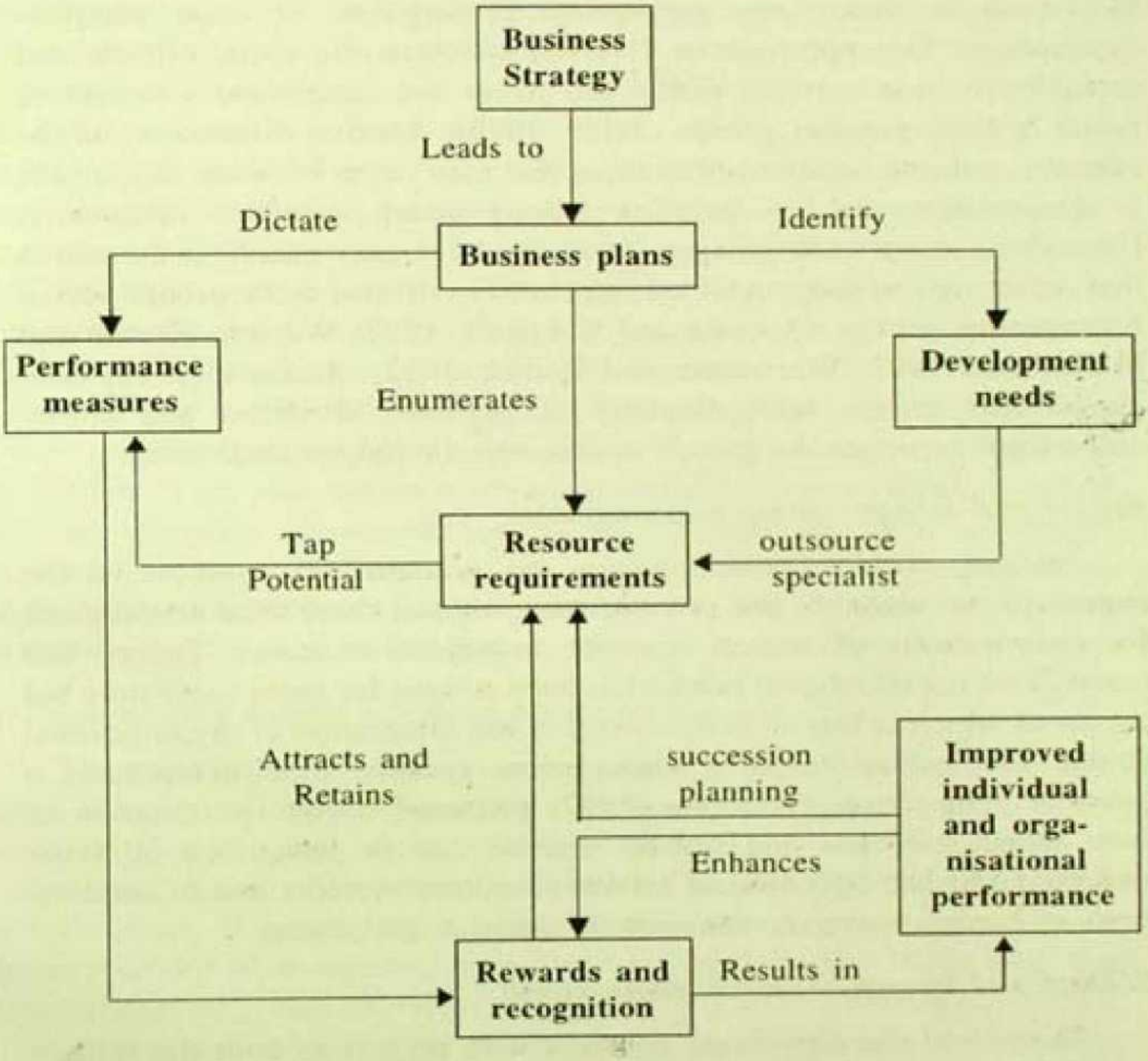
1. Aligning business strategy with human resource strategy.
2. Knowledge management and creating learning organisation.
3. Competent mapping and skill development through assessment centres.
4. Developing moral excellence through ethics audit and creating a value-based culture.
5. Reorganisation of work through job enlargement and enrichment.
6. Development of mutual trust and synergy among work teams.
7. Managing change through people.
8. Restructuring and bringing about transformation in the organisation to add value to the business.
9. Bringing about rationalisation of workforce through internal transfers and res oring to employee reduction.
10. Holding opinion surveys to get a feel of the perception of employees and applying mid-course correction, if needed.

Under the strategic human resource approach human resource also plays an expanded role. As indicated by Pfeiffer (1998), irrespective of the business strategy, human resources should be continuously aligned with it, which is in the interest of the organisation itself. The strategic human resource framework aims to leverage and align human resource practices to build critical capabilities that enable an organisation to achieve its goals (Merich and Lake, 1990). Michael Porter also argues in favour of strategic approach on human resource management and comments that it can help a firm to achieve competitive advantage. Figure:1 suggests how business strategy should be developed to achieve corporate goals and create value for the business.

A company should first decide what, as a whole, it needs to perform to achieve strategic competitive advantage and then formulate the strategic business plan. Effective human resource practices contribute to business performance : by building original capabilities, by improving employee satisfaction and by shaping customer and shareholder satisfaction. Dynamic changes in human resource measures are urgently required to refocus on the priorities and resources of the human resource functions. Instead of being human resource-driven, the new generation of human resource measures needs to be business-driven. Instead of being activity-oriented, new human resource measures need to be impact-oriented and instead of looking backward, innovative human resource measures should

be forward-looking, allowing the managers to access and diagonise the process that can predict the future success of the corporation (Kaplan, Norton, 1992).

FIGURE 1



Creates Shareholders value

Source : Human Resource Management, B. Pattanayak, p. 317

KEY ISSUES AND FUTURE DIRECTIONS IN HUMAN RESOURCE MANAGEMENT

This section articulates a number of significant concepts and issues in the organisational sciences that have interesting and integrative potential with human resource management to produce innovative streams of work.

Diversity and human resource management

The dynamics of human resource management are quite complex. People generally have substantial gaps in their knowledge about diversity in organisations. Moreover, these gaps severely limit the ability of an individual to make any appropriate prescription or even adequate descriptions. One approach to diversity concerns the social climate and social interaction patterns within the group and cohesiveness should be easier in homogeneous groups (Ziller, 1973). Another dimension, on the contrary, concerns culture differences that may occur between races, such as competition and co-operation among group members differently. However, a major underpinning of expected diversity benefit is the notion that creativity and judgement are improved in diverse work groups versus homogenous groups (Ancona and Caldwell, 1992; Watson, Kumar and Michaelson, 1993; Wierserma and Bantel, 1992). Jackson (1992) concluded that groups with diversity of personal attributes and ability outperform homogenous groups on creative or judgemental tasks.

Justice and human resource management

Notions of fairness and justice are fundamental concepts in the organisational sciences and provide quite logical theoretical foundations for examinations of human resource management issues. Theory and research on organisational justice has been around for quite some time but the arena which is less well developed is the integration of organisational justice and human resource management systems that incorporates a political perspective. Dulebohn (1997) proposed a conceptualisation of how social influence and justice reaction can be integrated in better understanding the operation of human resources systems and its implications in human resource management decision processes.

Science and human resource management

In spite of the significant progress with respect to both the science and practice of human resource management, there remains a gap between these two areas. Buckley, Ferris, Bernardino and Harvey (1998) have called this problem 'a disconnect' that scientists and practitioners seem to have segregated along these lines. Lawler (1985) attempted to bridge the gap by suggesting : (1) the outcome must facilitate practitioners' understanding of organisation and result in improved practices; and (2) the outcome must contribute to the theory and knowledge generated in the science of human resource management.

Accountability and human resource management

A number of recent works underscore the embeddedness of account-

ability in organisational foundations in stark contrast to the scarce representation of this construct in the organisational literature (Ferris, Mitchell, Canavan, Frink and Hopper, 1995). Theory and research on accountability holds substantial promise for the advancement of the human resource management knowledge base as many human resource management functions include accountability mechanisms comprising selection, performance evaluations and compensation (Ferris et al., 1995). Some related phenomena seem notable here. First, accountability and organisational policies seem natural companions for providing interesting and relevant information, and second, perceptions on how people respond to accountability requirements as they see them. Third is that of individual differences in responding to accountability. The final phenomenon is concerned about the need to relate accountability specifically to human resource management functions and concerns. Most of the information on accountability is related to human resource management functions such as CEO compensation, the future projection of the organisation etc. But some of the key areas like human resource valuation, environmental reporting are not properly accounted for by the entities for better financial presentation. However, there has been some sincere efforts by some erudite authorities in recent past to model the phenomenon, and these works may provide some conceptual frameworks to support and direct future works.

Accounting and human resource management

The roots of human resource management go as far back as the 1950s, when Drucker and McGregor stressed the need for visionary goal directed leadership and management of integration. This was succeeded by Behavioural Science Movement in the 1960s, headed by Maslow, Argyris and Herzberg. However, the origin of human resource management as a defined school of thoughts is usually traced back to the 1970s with the development of Human Resource Accounting Theory (Flamholtz, 1974). Human resource management encompasses those activities designed to provide, motivate and co-ordinate the resources of an organisation and above all, for the success of the organisation. The question that arises at this juncture is – what measures should the organisation take to influence the human resource capital. The issues involve are :

(a) Human resources no longer are seen as liabilities, rather as a key resource that needs to be carefully nurtured and constantly developed.

(b) While organisations are becoming conscious of the potential of new technology, they must also realise the crucial role that human resource plays in managing the technology.

(c) The organisation should cope up with the advancement and take up the challenges of this competitive environment for their survival through providing training to their personnel and creating innovative ideas.

(d) Advancement of information technology and achieving benefits out of its implementation has primarily been due to human skill and brilliance. Therefore it is stressing an obvious to lay emphasis on human resources and give importance that they deserve. In accounting the future benefits of such an investment have been ignored and the expenses incurred have been charged to consumption. Questions thus obviously have been raised relating to treating such expenses as capital that results in benefits to be recouped in future.

Human resource accounting, thus, represents a unique opportunity of extending the frontiers of accounting to human resource management. This correlation is necessitated due to the following major reasons :

(a) Cost of personnel needs to be measured for understanding the financial implications of the phenomena.

(b) Trend in the ratio of investment of human assets has been emerging in its importance.

(c) Human resources need to be valued and efforts should be initiated to quantify the qualitative factors in the best possible manner.

EMPLOYEE INFORMATION

Disclosure of information to employees has a very long history. In US at least 30 companies issued special annual employee reports in 1937, while the Canadian Department of Labour published a bulletin discussing reporting to employees in 1921 (Lewis, Parker and Sutcliffe,1984). However, information about employees is likely to be of interest not only to workforce but also to other stakeholders and other interested persons. Profits cannot be generated by a company without the support of its workforce and if a company desires to become successful in the long-term then it must invest not only in latest equipment but it must also invest in, and look after, its people. Thus, investors are likely to be interested not only in the financial structure and performance of a company, but also in its workforce. Information on such matters as training, labour turnover, and absenteeism rates, trade unions and industrial relations, health, safety and accidents and the numbers, cost and productivity of the workforce are all likely to help investors to assess both current and likely future programme.

The society, at large, is also interested in certain type of information such as, equal opportunity policies, job opportunities and working

condition etc. Some of the information on employees is found in most annual reports. However, there are significant differences in the amount and type of disclosures made. These differences are not solely, or even mainly, due to differences in legislative requirements, instead they tend to be due either to differences in employer-employee relations, or differences in wider company-society relationship.

It is perhaps surprising that, despite the various regulations in UK and US, the amount of employees related information that companies are required to disclose is extremely limited. In the UK, the Accounting Standards Steering Committee (ASSC) set up a working party in 1974 to examine the scope and aims of published financial reports. This gave rise to the publication of the corporate report in the following year. This report went considerably beyond the traditional view as the objective of the earlier annual report was to fulfil legal obligations to report to the owners of the company on the stewardship of the resources entrusted to the company. Instead ASSC concluded that corporate reports should seek to satisfy as far as possible the information needs of the users. The implicit responsibility referred to the report incumbent on every economic entity whose size or format renders it significant. This responsibility arose from the custodial role played in the community by economic entities (ASSC, 1975, p. 77). The report also argued that economic entities that concerned with the use of monetary, material and human resources should be responsible to report employment information to the community at large (p. 51).

The UK laws, however, have some legislative requirements in this area. Individual companies are required to disclose, in the Director's Report, information on employees contribution and the employment of the disabled if they employ more than 250 people. While the proposals of the corporate reports were not acted upon, companies in France are required by law to disclose a similarly extensive list of employee related information. In the late 1960s the committee, set by the then French President, suggested that the companies should publish an annual "Bilan Social" or Social Balance Sheet. This leads to a requirement, passed in 1977, for all large companies to publish such a Social Balance Sheet (Grey, Owen, and Adams, 1996).

The UN Group of experts on International Standards of Accounting and Reporting issued a draft set of disclosure requirements that should be met by all large transnational corporations. It is not only the EU that has some requirements for the disclosure of employee related information, the USA requires the total number of employees, while Japan goes further stricter regulations. A few other countries have also long history of extensive disclosure on human resources. Reporting of these resources was more extensive in Germany in the early 1970s than in most countries

twenty years later. The disclosure generally concentrates on some sort of breakdown of employee numbers, employee cost, and particularly popular were breakdowns by: salaried versus hourly paid, female and male, age distribution, apprenticeship programmes, training programmes, details of pensions and retirement benefits etc. Two other areas where some interesting disclosures may be found are training and health and safety. Training information provides an indication of a companies investment in its personnel and may therefore provide a useful information of the company's commitment to the future and its likely long-term success. Information on health and safety may again provide some indication of a company's commitment to the workforce and is likely to be a significant factor in determining employees' satisfaction with the employer (or company) and their commitment to the company's long term success.

HUMAN RESOURCE ACCOUNTING : THE CONCEPT

Human resources are indispensable components of an organisation. They represent the work force of all levels engaged within an entity. The inanimate objects alone in an organisation can produce nothing without the help from human resources. Hence the objectives of an organisation should be to acquire their services, to develop their skill, to motivate the people to enhance their level of performance and ultimately to ensure that they continue to maintain their commitment to their organisation. The increasing awareness among human beings is compelling organisations to put greater and greater emphasis on human aspect in management decision. This has led to shift in focus from personnel management to human resource management and subsequently from human resource management to human resource development and ultimately to human capital or intellectual capital, a buzzword of the twenty-first century.

With the increasing sizes and complexities of business units, advancement in the economic role of the government, the emergence of strategic management within and outside the organisation and development in the accounting techniques necessitate to bring new dimensions in accounting for a vital element of resources – man. At present, the chief executives of the organisations are very much concerned with the ideas: what is the impact of inclusion of human resources in the financial statements? Can the performance of these resources be measured and shown in the balance sheet? What purpose these financial reports will serve if human resources find a place in the annual accounting statement?

Since long past, the concept of accounting for the services of the human resources failed to make any impact to the recipient due to their lack of knowledge and understanding about this specialised subject. As

such the concept did not take a concrete form in the early writings. Adam Smith contemplated the investment in human capital, while, Alfred Marshal commented, 'the most valuable of all capital is that invested in human beings'. In 1964 Hermanson suggested an 'unpurchased goodwill method' for valuation of human assets. In 1967 in the Harvard Business Review, Hekimian and Jones emphasised on the importance of information on human resources decision in the annual accounting statements. Rensis Likert also pronounced in his writings the importance of human asset accounting and the relative consequences, both internal and external, to the organisation. According to the Committee on human resource accounting of the American Accounting Association 'Human resource accounting is the process of identifying and measuring human resources and communicating this information to interested parties.

The arguments in favour of human resource accounting are enumerated below :

a) The conventional accounting system considers the expenses incurred on selection, recruitment, placement, training etc. as current revenue expenses rather than an investment for the purpose of being amortised over its useful economic life. As such the conventional balance sheet fails to represent the value of human resources as asset. Hence, these financial reports are unable to reflect the true value of the enterprise and the related rate of return on actual investments. However, incorporating human resources as an asset can portray a brighter image than what was earlier. This is why information on human resources is necessary to provide a complete picture of the asset holding of an organisation.

b) Management as a strategic tool for control can use data derived from human resource accounting. According to Flamholtz, the concept provides information to management on acquiring, developing, allocating, conserving, utilising, evaluating and awarding human resources which has also crucial significance in the management control system.

c) R.H.Hermanson contemplated that the financial statements with information on human resource assets would be more complete and useful to decision-makers, both internal and external, to decide on future based on the periodic measurement of causal and intervening variables. Where the causal variables denote the strategy, skill and policies of leadership, the intervening variables reflect internal health, state and capabilities of an entity.

d) The human-asset investment ratio may be regarded as an important indicator in respect to the relative position of human

resources in relation to the total assets of the organisation and serve as an important indicator of future profit performance to the investors and other interested parties.

e) The users of accounting information would be served better if non-monetary attributes are presented in the annual reports. This is because measurement of services and reporting of such non-monetary attributes will make the information system more logical and authentic.

f) Management may also be benefited from the information on human capital in their financial statement as it would result in developing employees behaviour and skill, monitoring their efficiency of performance, lowering turnover and absenteeism and improving human relations. Human resources when placed in the balance sheet as an asset of the organisation will obviously render psychological impetus to the employees which ultimately influence their performance.

g) The funding authorities are concerned about the future profitability which is the outcome of the productivity of human resources associated with an organisation. This is why human resources should be presented in the financial statements to give a more meaningful and comparable measure of productivity. Moreover the profitability represents the performance and creditworthiness of an entity and such information can only be portrayed by incorporating value of both human and non-human assets in the financial statement of the organisations.

h) Human resource accounting also helps the management in utilising the human resources in the most efficient and effective manner possible and ultimately stipulating a conceptual framework on the acquisition, development, allocation, conservation etc. designed to influence the value of people in an organisation.

Thus it is evident that to provide a more realistic and comprehensive picture of an entity human resources should be incorporated in the financial statements which can ultimately be used as an important strategic tool for financial analysis of an organisation.

MEASURING HUMAN RESOURCE COST

Current accounting and reporting practices for most companies treats all expenditures for investments in human resources as expenses rather than as assets, resulting in distorted measures on return on investment (Flamholtz, 1974). According to him, this accounting convention motivates

management to emphasis short-term results because managers are concerned with their bottom-line and under the present accounting practices, human resource expenditure directly decreases net income. Human resource accounting can provide valuable information, facilitate corporate social accountability for employees and control the depletion and liquidation of the companies' human capital. Questions generally arise: what costs are involved in human resources, how can these costs be amortized and how is the write-off to be accomplished? Flamholtz has defined cost in terms of sacrifices that need to be made to be able to acquire tangible and intangible benefits. Three different concepts may be employed in measuring human resource costs : (a) historical cost; (b) replacement cost; and (c) opportunity cost. According to Rensis Likert and his associates (1967) the historical cost is calculated by capitalising all the costs incurred to recruit, hire or train an employee. However, the model is suffered on the ground that it can hardly project the real value of service potentials of human resources. Under the replacement cost method the human resource cost refers to the cost of replacing the present set of employees with another set of equal set of equal ability. Flamholtz (1974) described two types of replacement costs : positional, where the best substitute would fill a vacancy; and personnel, which required the employment of a substitute who is similar in ability. The third component – seperation costs – are costs incurred with the departure of a particular employee. Jaggi commented that replacement cost has the potential to consider the performance of an individual within an organisation rather than the position the individual holds. Flamholtz noted two additional advantages in its favour ; human resource planning and control process and potential uses in developing surrogate measures of the value of people to organisation. The model is criticised, as the psychology behind replacement of present set of employees with another set is not considered here. According to Hekimian and Jones (1967) under opportunity cost method human resource value is determined by the amount they could earn if employed in alternative functions. Jaggi (1974) suggested that one advantage of this method was that it provided greater flexibility taking into account the fact that different individuals have different values to the organisation. The method is an eye-opener in the sense that an employee should be engaged in such a way that the company can be benefited to its optimum level.

MEASURING HUMAN RESOURCE VALUE

According to Flamholtz (1974), the value of human resource is derived from the future services to be rendered to the organisation. In

principle, the value of people can be defined as the present worth of the expected future services in the same way as for other resources. According to the model, an individual's expected realisable value be described as the amount an organisation expects to derive from an individual's services, taking into account the individual's likelihood staying with the organisation. According to Likert and Bowers (1973) the causal variables such as management behavior and organisational structure and intervening variables such as group processes, leadership and organisational climate are very important considerations which effect a group's value to an organisation. Hermanson (1964) proposed two monetary human resource valuation techniques : the unpurchased goodwill method and the adjusted present value method. The unpurchased goodwill method was based on the belief that if a firm earned a higher than normal rate of return, that was evidence of the existence of superior operational assets (including human resource assets). Goodwill is the resultant of managerial ability, social and personal attributes, special skills and knowledge, established clientele and workforce and favourable trade developments which lead to a good reputation. Of the various methods of valuation of human resources the most globally accepted and acclaimed model was designed by Baruch Lev and Aba Schwartz (1971), monetary human resource valuation model, where employee salaries are surrogates for economic value. According to the authors the valuation of human resources of homogeneous group can be done by aggregating the present value of wages and salaries payable to individual employees during their stay within the organisation. The derivation of a firm's human capital value in this way would permit to formulate a new set of financial ratios. The first being the ratio of human to non-human capital values to indicate the degree of labour intensiveness and second, changes in the structure of the labour force. The other model framed by Flamholtz, the stochastic reward valuation model, determines the value of employees based upon the expected service they perform in each 'service state'. There are a number of other models suggested by other erudite authorities. Each model presents the issue of human resource valuation from a different angle and each is subject to rigorous criticism. However, the model suggested by Baruch Lev and Aba Schwartz, has wide recognition and is used by a number of organisations, both in India and abroad.

HUMAN RESOURCE ACCOUNTING AND CORPORATE SOCIAL RESPONSIBILITY

Human resource accounting, it is argued, is one of the most wide-ranging developments in the social sciences. Glautier (1976) suggested that

the genesis of human resource accounting be found in the application of behavioural science concepts to the business organisation and its management. However, the link between the behavioural view of the organisation and human resource accounting is perhaps best seen in the seminal work of Likert (1967) and Likert and Bowers (1968) which highlighted the need for information about the human element in organisation.

Human resource accounting has a particular role to play as regards the concept of corporate social responsibility. The social effectiveness of an organisation is being reflected in the quality of social relationships and should be reflected in benefits accruing both to the organisation and to its members. These benefits are the non-financial rewards accruing to employees in the form of job satisfaction and to the organisation in the form of added element of organisational effectiveness attributable to this factor. The quality of organisational relationships implies a great deal of job satisfaction and employee motivation. It implies the consideration of social contribution to employees in the form of increased monetary and non-monetary benefits, participation in management and improved industrial relations. However, it is evident that the financial value of human resources depends to a considerable extent on the quality of industrial relations. Industrial relations, in a broader term, refer to the whole spectrum of contract between the organisation and its employees. Though the wage bargain is often the central focus of debate, it is fair to regard the wage bargain as the apex of a complex set of relationships implied in the recognition of the firm as a social unit.

The disclosure of information to employees and their trade unions is of critical importance to good industrial relations. The attitude of employees will be determined in part by what they know about the organisation which employs them and conversely, the attitude of management will be influenced by how much they know about their employees. The consideration of the information requirement for collective bargaining led to the Trade Union Congress Report (1970). The list suggested by the report was to detail information on : general objective, man power, financial prospects and plans. The list also indicates the desirability of widening the range of conventional accounting disclosure to include both financial and non-financial information. The traditional financial report fails to satisfy the user's need. It highlights the growing importance of manpower planning and utilisation, and in this respect underlines the potential functional usefulness and social relevance of human resource accounting. It repeats the urgency of developing non-financial measures of effectiveness to supplement standards of performance based on financial measures.

APPLICATION OF HUMAN RESOURCE ACCOUNTING SYSTEM

Despite the difficulties associated with the measurement of human asset value, a number of interesting experiments have been made in developing operational human resource accounting systems. The R.G. Barry Corporation (1969-71) is the most celebrated example of the attempt to derive human asset values from the financial accounting data and to integrate the values in a conventional financial balance sheet. Woodruff, the VP of the R. G. Barry Corporation commented that the study, aside from providing managers with more accurate profitability statements and increasing managerial awareness of the importance of human resources, a human resource accounting system can help to answer the questions :

a) How should an organisation allocate resources among various competing opportunities?
b) What are the real costs to the company of the replacement turnover of personnel?
c) Are sufficient human capabilities being acquired to achieve the objective of the organisation?
d) Are they being developed adequately?
e) To what degree are they being properly maintained?
f) Are these capabilities being properly utilised by the organisation?

Touche Ross and Company calculated the investment in each employee in terms of outlay and opportunity costs and generated four human resource reports: 'The Cost of Time Analysis Report', 'A Summary of Human Resource Investments Report', 'A Statement of Human Resource Flows Report' and 'Contribution Report'.

In another application of human resource accounting, Flamholtz and Lundy (1975) successfully developed a system of measuring human resource value in Lester Witte and Company, a CPA firm. The Stochastic Process model developed by Flamholtz was being considered.

At AT&T, human resource accounting was designed to increase managerial effectiveness in the development and retaining of employees. Historical cost approach was used to measure for separate cost components: employment costs; training costs; efficiency recovery costs and extra supervision costs.

Flamholtz and Coff (1989) addressed the issue of using human resource accounting for tax-savings purposes when buying a service company. The author pointed out the reasons why acquirers of knowledge-bases business should undertake the value of human resource assets. General Motor Corporation, which acquired Hughes Aircraft Company for \$ 5.2 billion in 1988 and in the purchase, \$ 4.4 billion was assigned to

goodwill, but a substantial portion of that actually represented payment for the expertise of Hughes' people.

In India a very few enterprises, both in the public and the private sector, value their resources and publish the same in their annual statements. Such companies include Bharat Heavy Electricals Limited (BHEL), Steel Authority of India Limited (SAIL), Minerals and Metal Trading Corporation (MMTC), Oil and Natural Commission (ONGC), Associated Cement Company (ACC), Hindusthan Machine Tools (HMT) , Tata Engineering and Locomotive Works (TELCO), Oil India Limited (OIL), National Thermal Power Corporation (NTPC), Cement Corporation of India (CCI), Hindusthan Shipyard Limited (HSL), Southern Petro-Chemical Corporation (SPC) and others. Most of the organisations have adopted the Lev-Schwartz model for valuation purposes. However, SAIL and CCI have reported human resource value based on the Lev-Schwartz model with certain modifications. Satyam Computer Services Limited has also used the Lev-Schwartz model for computing their human resource assets for 2001-2002. The intangible assets comprising of human resource value and brand value together represent 82.36% of the total assets of the organisation.

CONCLUSION

There is no doubt about the fact that progressive and innovative human resource management policies and practices make good business sense as there is a strong linkage between human resource management systems and firm performance. However, the difficulty is that there are indeed compelling pressures from financial community that often discourage investment of company resources in "difficult-to-measure activities" like human resource management practices. Despite such compelling pressures, it seems quite clear that the spirit of the times we are currently experiencing favours valuation of human resources, and implementation of innovative human resource practices. Techniques and measurements are required which will allow behavioural and social problems to be considered. Whilst it is true that accounting has a focus on monetary data, it is also true that this focus has impeded the flow of information about activities which cannot effectively be expressed in monetary terms. Apparently, there is a need for non-monetary measures of effectiveness which will reflect the behavioural and social aspects of organisational activities. Human resource accounting, thus, is not only a way of improving the efficiency of workforce but also a means of improving the effectiveness of business organisation viewed as complex social units.

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CREATIVITY : AN IMPORTANT FACTOR FOR IMPROVING QUALITY OF WORK-LIFE (QWL)

SRUTINATH PRAHARAJ

Necessity is the mother of inventions, goes the famous adage. All kinds of human needs have led to acts of creation. Famous penicilin drugs were discovered in response to some serious diseases. The drive for money and power has led to growth of vast enterprises and power structures. And, of course, the needs to be creative and to make distinct contributions are the springboards of much of the scientific and artistic ventures. Thus, any human need, when it is strong enough, can, if the circumstances encourage and permit, result in an act of creation. Yet, there is a difference. There are certain needs that once satisfied, no longer help generate creative behaviour. These are needs for security, power, etc. On the other hand, there are some other needs that underlie positive, creative urges. Self actualisation, i.e., the need for the development of one's potential, is an example of such a need. There is a special need, probably the most important motivating factor, behind all creative urges. This is the need to create, to discover, to pioneer and to do something original and distinctive. This is a need that not only helps one realise his/her potential but also impels one to seek a distinctive expression of his potential.

Any kind of achievement is likely to depend, inter alia, on adequate motivation supportive environment, and on certain habits and skills. Lack of motivation or absence of appropriate environment or inadequate skills may cause achieving anything but significant. However, the chance of success may be quite high and, indeed, the probability of that rises fast, if the factors like the motivation, the environment, etc., are favourable.

Creativity of an individual is, no doubt, an important factor. Even more important, perhaps, is the creativity of the groups of people, such as the organisations, the communities and the society itself. After all, creativity is very much a team effort and requires co-operation and co-ordination of a large number of people. Therefore, every organisation has its role to help unlock individuals' creative urges.

An individual's creative ability consists of several distinct abilities vis-a-vis divergent thinking. These are : (1) fluency ability – to come up with a large number of ideas or solutions or concepts or words in response to a given stimulus; (2) flexibility ability – to come up with a variety of

ideas or solutions or techniques; (3) originality ability – to come up with useful ideas or solutions that others have not thought of; (4) sensitivity ability – to sense problems, anomalies, issues, feelings, shapes, sounds, relationships, etc.; (5) guessing ability – to guess causes of a situation or a problem as well as the likely consequences of the situation; and (6) elaboration ability – to develop fully the potential of an idea or an insight.

The environment shapes our creativity in various ways. It may block or facilitate creative activities. Essential requisites of a creative environment are :

(a) It should be stimulating.
(b) It should encourage and reward creativity.
(c) It should not induce defensiveness and fearfulness by premature criticism.
(d) It should provide opportunities for feedback and critical but constructive evaluation and rigorous technical training.
(e) It should be rich in diversity and intellectual ferment.
(f) It should provide for freedom of thought and action.
(g) Innovators, pioneers and creators should be viewed as role models.
(h) It should provide reasonable physical facilities for experimentation.

OBJECTIVES OF THE STUDY

In our country, as we have come across, some studies have been made with respect to QWL and its related aspects. Work reorganisation or planned change has been identified as the causal factor vis-a-vis enhancing QWL. In fact, in India, except for a few projects, in all organisations, where QWL-improvement-programmes/work-redesigning, etc., have been initiated, the outcome cannot be said to be positive and significant. This has happened because serious attempts have not been made to understand properly the meaning and the implications of QWL-improvement process before operationalising it.

For the purpose of obtaining maximum benefits arising out of this true process, further research, covering different aspects of QWL, should be made. This is more so because the concept has different connotations for different groups of people in different types of organisations. Redesigning of work at different organisational levels is also an imperative.

In our country and abroad, different observations on QWL suggest that the essence of QWL is the opportunity for employees, at all levels, to have

substantial influence over their work environs by participating in the decision-making process relating to their work and, thereby, enhancing their self-esteem and overall satisfaction from their work. We think that the essential component of QWL-improvement programme is the existence of a real, and ever present, opportunity for the individuals at any level in an organisation to influence their working environs, i.e., to have some say over what goes on in connection with their work. It calls for an open style of management, i.e., sharing of information and genuinely encouraging the efforts relating to the improvement of the modus operendi in vogue.

Since industrialisation has come to India largely through haphazard transplantations of industrial institutions from abroad, we have different organisations at different stages of evolution and the need for improving the QWL has gradually increased over the years, particularly in those organisations where physical working conditions are not healthy enough, work is organised in a traditional manner and the nature of work contributes to generation of frustration, etc.

The present study relating to QWL covers only the executives in the Government departments of West Bengal. The 'Working Life' concept covers a number of aspects of work organisation, each of which plays its role vis-a-vis working life. Out of certain major aspects the factor considered here is creativity, the assumption being that such aspect has significant impact on organisational systems and processes vis-a-vis gratification of psycho-social needs of employees and generation of a work atmosphere that help realise human potential in the truest sense. For a detailed classification, the factor was divided into two important sub-factors, such as –

(i) individual's creative behaviour, and
(ii) role of organisation.

METHODOLOGY

For an effective survey for the study, a questionnaire, containing seventeen items other than the items relating to personal profile, was administered to the civil executives of West Bengal (serving in and around Kolkata).

450 executives out of a total population of 1767 have responded effectively representing pratically all the Government departments. Keeping the extreme business of the respondents in mind, the questionnaire was administered individually and they were assured that their personal profiles and responses would be kept strictly confidential. This was particularly necessary because the executives in the Government departments had the

apprehension that their responses might be leaked out and adversely used by their superiors. Responses, through the questionnaire, were supplemented by structured interactions with some selected respondents.

For analysing the responses, four independent biographical variables -- Age, Education, Experience and Sex -- have been considered. Two simple and commonly used statistical tests have been applied to derive meaning out of the data collected – Mean and Chi-square. While calculating the mean values for each of the seventeen items in the questionnaire, different weights (viz, 1, 0, 0.5) have been considired for quantifying the responses. The weight assigned for the positive responses vis-a-vis a healthy QWL is 1 (one), for the negative responses vis-a-vis a healthy QWL is 0 (zero) and for the responses, which can be considered as 'Undecided' in character, is 0.5.

The class limits for the independent variables -- Age, Education and Experience, have been reduced to three (3) each in case of Age [Young (26-35), Middle-aged (36-45) and Aged (46 and above)] and four (4) in case of Education for the purpose of computing the Chi-square values. Chi-square (χ^2) values have been computed with a view to finding out the association between the attributes. Infact, if two attributes are not 'independent', they are said to be associated, i.e. there is an association between the two attributes.

If the calculated value of χ^2 exceeds the tabulated value for the given degrees of freedom and at a specified level, this may indicate that the attributes are not 'independent' but 'associated'. Incidentally, for the independent variable Sex, the number of female respondents has been 36, representing only a very negligible portion (8%) of total sample. Thus, Sex has not been separately considered for the purpose of Chi-square test. In case of some questionnaire-items, which are purely non-parametric in nature, the Chi-square values have not been considered for obvious reasons.

'Contingency Coefficient (C)' in the Chi-square table, which indicates the degree of relationship between the attributes. The higher the value of C, the greater is the degree of association.

PRESENTATION OF DATA

TABLE 1

CR-1	A good communicator is necessarily a good listener ☐ Agree ☐ Disagree ☐ Undecided
CR-2	Dogmatic tendency provides some protection in a highly hostile situation. ☐ Agree ☐ Disagree ☐ Undecided
CR-3	Conformity to the norms of the society helps one to get acceptance. ☐ Agree ☐ Disagree ☐ Undecided
CR-4	You are afraid of any sort of social criticism/punishment and humiliation. ☐ Agree ☐ Disagree ☐ Undecided
CR-5	Most people have a tendency to become dependent and passive and that is why they feel helpless ☐ Agree ☐ Disagree ☐ Undecided
CR-6	You prefer to participate only in those activities in which you are resonably sure to win. ☐ Agree ☐ Disagree ☐ Undecided
CR-7	Fear of failure goads a person to make a better and more focussed effort towards any task. ☐ Agree ☐ Disagree ☐ Undecided
CR-8	You always like to keep yourself away from the creative efforts simply because of some unavoidable ambiguities involved. ☐ Agree ☐ Disagree ☐ Undecided
CR-9	The atmosphere of your organisation favours creativity. ☐ Agree ☐ Disagree ☐ Undecided
CR-10	Your organisation climate encourages you to pursue your hobbies interests. ☐ Agree ☐ Disagree ☐ Undecided
CR-11	Your organisation is receptive to new ideas. ☐ Agree ☐ Disagree ☐ Undecided
CR-12	Your organisation genuinely wants its executives to make use of new knowledge/skills acquired. ☐ Agree ☐ Disagree ☐ Undecided
CR-13	Your organisation treats you as a mature individual. ☐ Agree ☐ Disagree ☐ Undecided
CR-14	You have the opprtunity of participating in a meaningful manner in the process of formulating policy/procedure/programme / budget strategy/ tactic. ☐ Agree ☐ Disagree ☐ Undecided
CR-15	You feel free to make some changes in your department ☐ Agree ☐ Disagree ☐ Undecided
CR-16	You are free to set your own performance goals. ☐ Agree ☐ Disagree ☐ Undecided
CR-17	You have developed physical ailments like hypertension, heart diseases, etc., due to excessive stress and strain in your work place. ☐ Agree ☐ Disagree ☐ Undecided

TABLE 2

Item No. No.	Freqency	Agree		Disagree		Undecided		Mean of	Connotation Mean Value
		No.	%	No.	%	No.	%		
CR-1	450	304	67.56	67	14.89	79	17.56	.76	AGREE
CR-2	427	62	14.52	336	78.69	29	6.79	.	82ISGREE
CR-3	416	84	20.19	98	23.56	234	56.25	.52	UNDECIDED
CR-4	442	22	4.98	173	39.14	247	55.88	.67	DISAGREE
CR-5	441	273	61.90	86	19.50	82	18.59	.29	AGREE
CR-6	450	142	31.56	238	52.89	70	15.56	.61	UNDECIDED
CR-7	422	160	37.91	137	32.46	125	29.62	.47	UNDECIDED
CR-8	440	66	15.00	314	71.36	60	13.64	.78	DISAGREE
CR-9	445	63	14.16	365	82.02	17	3.82	.16	DISAGREE
CR-10	450	93	20.67	295	65.56	62	13.78	.27	DISAGREE
CR-11	437	42	9.61	365	83.52	30	6.86	.13	DISAGREE
CR-12	442	119	26.92	281	63.57	42	9.5	.32	DISAGREE
CR-13	429	152	35.43	73	17.02	204	47.53	.59	UNDECIDED
CR-14	450	30	6.67	349	77.56	71	15.78	.14	DISAGREE
CR-15	450	87	19.33	247	54.89	116	25.78	.32	DISAGREE
CR-16	447	76	17.00	274	61.3	97	21.7	.28	DISAGREE
CR-17	432	72	16.67	157	36.34	203	46.99	.60	UNDECIDED

** The data were collected during 1988-90.

TABLE 3
AGE (%)

Item Group	26-35			36-45			46 and above		
	Agree	Disagree	Undecided	Agree	Disagree	Undecided	Agree	Disagree	Undecided
CR-1	61.9	15.1	23.0	66.8	14.7	18.5	77.9	15.1	7.0
CR-2	14.4	75.4	10.2	16.8	78.3	4.9	8.4	84.3	7.3
CR-3	19.0	39.7	41.3	12.6	19.2	68.2	42.0	11.1	46.9
CR-4	5.6	55.6	38.7	2.1	35.2	62.7	11.8	25.9	62.3
CR-5	53.7	27.6	18.7	62.2	17.6	20.2	72.9	12.9	14.2
CR-6	15.9	61.1	23.0	37.0	51.3	11.7	39.5	45.3	15.2
CR-7	36.2	31.9	31.9	37.6	32.3	30.1	41.0	33.7	25.3
CR-8	9.1	76.0	14.9	14.5	73.5	12.0	24.7	58.8	16.5
CR-9	11.3	84.7	4.0	13.2	84.3	2.5	20.9	72.1	7.0
CR-10	12.7	72.2	15.1	23.1	63.9	13.0	25.6	60.5	13.9
CR-11	8.9	87.8	3.3	8.3	85.2	6.5	14.3	72.6	13.1
CR-12	17.6	74.4	8.0	28.8	65.2	6.0	35.7	42.9	21.4
CR-13	42.4	13.6	44.0	29.1	18.9	52.0	42.9	16.7	40.4
CR-14	5.6	85.7	8.7	5.5	81.9	12.6	11.6	53.5	34.9
CR-15	14.3	61.9	23.8	9.7	57.1	33.2	53.5	38.4	8.1
CR-16	15.3	66.9	17.7	15.2	65.0	19.8	24.4	63.0	32.6
CR-17	11.8	48.7	39.5	17.7	36.4	45.9	30.7	18.3	61.0

TABLE 4
Education (%)

Item/ Group	Graduate			Graduate & Others			Post Graduate Post			Graduate & Others		
	Agree	Disagree	Undecided	Agree	Disagree	Undecided	Agree	Disagree	Undecided	Agree	Disagree	Undecided
CR-1	62.8	16.1	21.1	74.2	15.5	10.3	68.0	13.3	18.7	73.3	11.7	15.0
CR-2	15.9	76.3	7.7	14.9	79.8	5.3	12.7	81.7	5.6	10.9	81.8	7.3
CR-3	22.3	16.1	61.7	17.0	22.3	60.6	13.9	30.6	55.6	26.3	42.1	31.6
CR-4	5.1	38.1	56.7	5.3	37.2	57.4	5.3	52.0	42.7	3.4	29.3	67.2
CR-5	61.9	20.5	17.7	66.7	19.4	14.0	49.3	16.0	34.7	70.7	20.7	8.6
CR-6	34.9	52.8	12.4	26.8	60.8	12.4	38.7	42.7	18.6	18.3	53.3	28.3
CR-7	37.6	31.2	31.2	35.9	32.6	31.5	40.6	27.5	31.9	39.3	42.9	17.8
CR-8	16.4	69.2	14.5	11.8	74.2	14.0	16.2	73.0	10.8	13.6	72.9	13.6
CR-9	14.7	82.9	2.3	15.6	79.2	5.2	11.1	88.9	0.0	13.3	75.0	11.7
CR-10	23.9	65.6	10.6	18.6	70.1	11.3	18.7	56.0	25.3	15.0	70.0	15.0
CR-11	11.4	81.5	7.1	8.5	86.2	5.3	9.5	82.4	8.1	5.2	87.9	6.9
CR-12	28.2	63.9	7.9	19.1	73.4	7.4	35.1	51.4	13.5	24.1	62.1	13.8
CR-13	28.1	17.6	54.3	40.2	15.2	44.6	40.8	23.9	35.2	48.2	8.9	42.9
CR-14	2.8	80.7	16.5	8.2	81.4	10.3	14.7	66.7	18.6	8.3	73.3	18.4
CR-15	21.6	52.8	25.7	26.8	53.6	19.6	6.7	64.0	29.3	15.0	53.3	31.7
CR-16	16.3	63.3	20.5	20.6	62.9	16.5	12.0	58.7	29.3	20.7	56.9	22.4
CR-17	20.2	31.0	48.8	16.5	33.0	50.5	11.1	51.4	37.3	10.7	42.9	46.4

TABLE 5
Experience (%)

Item Group	1-10 Years			11-20 Years			21 years and above		
	Agree	Disagree	Undecided	Agree	Disagree	Undecided	Agree	Disagree	Undecided
CR-1	60.5	18.6	20.9	67.1	13.8	19.2	80.2	12.3	7.4
CR-2	17.6	72.8	9.6	13.8	80.8	5.4	[illegible]	82.1	6.4
CR-3	15.4	45.3	39.3	19.9	14.5	65.6	28.2	16.7	55.1
CR-4	4.7	56.3	39.1	1.7	34.6	63.7	15.0	25.0	60.0
CR-5	53.9	29.7	16.4	62.4	15.4	22.2	73.4	15.2	11.4
CR-6	20.9	64.3	14.7	37.5	52.1	10.4	30.9	37.0	32.1
CR-7	41.5	30.5	28.0	36.8	33.2	30.0	35.8	33.3	30.9
CR-8	7.3	78.2	14.5	16.0	68.5	15.5	24.4	69.2	6.4
CR-9	13.3	82.0	4.7	15.1	80.7	4.2	12.7	86.1	1.3
CR-10	16.3	76.0	7.7	20.0	64.6	15.4	29.6	51.9	18.5
CR-11	7.9	89.7	2.4	9.5	83.1	7.4	12.5	75	12.5
CR-12	19.8	72.2	7.9	30.2	62.1	7.7	28.4	54.3	17.3
CR-13	42.5	9.4	48.0	30.7	24.9	44.4	37.7	6.5	55.8
CR-14	7.8	78.3	14.0	6.7	78.3	15.0	4.9	74.1	21.0
CR-15	9.3	62.8	27.9	18.8	55.8	25.4	37.0	39.5	23.5
CR-16	14.1	60.9	25.0	16.7	64.9	18.4	22.5	51.3	26.3
CR-17	20.5	33.6	45.9	15.2	38.1	46.8	15.2	35.4	49.4

TABLE 6
Independent Variables

Item/	Age				Education				Experience			
	χ^2 Values	Contingency Coefficient (C)	Significance 5%	Significance 1%	χ^2 Values	Contingency Coefficient (C)	Significance 5%	Significance 1%	χ^2 Values	Contingency Coefficient (C)	Significance 5%	Significance 1%
CR-1	Does Not Arise	–	–	–	Does Not Arise	–	–	–	Does Not Arise	–	–	–
CR-2	Does Not Arise	–	–	–	Does Not Arise	–	–	–	Does Not Arise	–	–	–
CR-3	Does Not Arise	–	–	–	Does Not Arise	–	–	–	Does Not Arise	–	–	–
CR-4	34.202	0.27	Yes	Yes	8.818	0.14	No	No	45.338	0.30	Yes	Yes
CR-5	Does Not Arise	–	–	–	Does Not Arise	–	–	–	Does Not Arise	–	–	–
CR-6	23.142	0.22	Yes	Yes	17.420	0.19	Yes	Yes	26.003	0.23	Yes	Yes
CR-7	Does Not Arise	–	–	–	Does Not Arise	–	–	–	Does Not Arise	–	–	–
CR-8	11.698	0.16	Yes	No	1.891	0.06	No	No	14.495	0.18	Yes	Yes
CR-9	8.190	0.13	No	No	15.803	0.18	Yes	No	2.256	0.07	No	No
CR-10	7.116	0.12	No	No	13.289	0.17	Yes	No	14.080	0.17	Yes	Yes
CR-11	11.076	0.16	Yes	No	2.830	0.08	No	No	9.810	0.15	Yes	No
CR-12	30.677	0.25	Yes	Yes	10.862	0.15	No	No	12.334	0.16	Yes	No
CR-13	8.693	0.14	No	No	16.038	0.19	Yes	No	22.407	0.22	Yes	Yes
CR-14	37.401	0.28	Yes	Yes	17.140	0.19	Yes	Yes	2.503	0.07	No	No
CR-15	86.331	0.40	Yes	Yes	14.155	0.17	Yes	No	25.294	0.23	Yes	Yes
CR-16	15.247	0.18	Yes	Yes	6.222	0.11	No	No	6.494	0.12	No	No
CR-17	19.970	0.21	Yes	Yes	12.998	0.17	Yes	No	2.085	0.07	No	No

ANALYSIS AND INTERPRETATION

This study has considered two different aspects of creativity, viz., an individual's creative behaviour and the role of the concerned organisation in that connection. There is every reason to believe that an individual's creative potential can be realised and it can result in dramatic gains for the organisation provided the working environment supports the individual in terms of appropriate motivations, training and development etc.

CR-1 : Analysis (Table-5) shows that most of the senior executives (80.2%) and a large number of executives covering all the age and qualification groups (Table-3&4) have agreed that a good communicator is necessarily a good listener.

CR-2 : Most of the respondents (more than 75%) irrespective of their age, qualification and experience (Table-2), do not agree with the statement that dogmatic tendency provides some protection in a hostile situation.

CR-3 : While responding to this question, a good number of middle aged (Table-3) executives (more than 60%), covering all the qualification groups except 'post-graduate & others' (Table-4), have remained undecided whether conformity to the norms of the society helps one get acceptance.

From the above analysis it appears that, on an average more than 67% of the executives (Table-2) are of the view that a good communicator is necessarily a good listener. This is certainly a positive indicator of an individual's creative ability. However nearly 15% of them do not subscribe to such a view. One of the confirmed barriers to an individual's creativity is dogmatism. The majority of them have responded negatively vis-a-vis the statement : dogmatic tendency provides some protection in a highly hostile situation. The experts in the field of management of creativity say that the fear of social criticism or punishment results in conformity. Here, only 23% of the executive have disagreed with the statement that conformity to the norms of the society helps one get acceptance, where majority of them have remained undecided. It is true that conformity to the norms of the society or collective wish helps one get acceptance but it also resists one from coming out with creative ideas and divergent thinking and, ultimately, it may lead to missing of opportunities for growth and self-actualisation.

CR-4 : Table-3 shows that nearly 55% of the young executives having P.G. degree are not stated to be afraid of any sort of social criticism/ punishment and humiliation while most of the middle aged and aged executives have remained undecided. Only 3 to 5% of them covering all the qualification groups (Table-4) are stated to be afraid of such criticism/ punishment and humiliation--a positive sign vis-a-vis creativity. It is

interesting to note that the young/junior executives by and large (Table-5), do not think that they are afraid of such criticism, etc., (as compared to the other categories of executives). The possible reason might be that the young people have a tendency to challange the tradition and they care less about social criticisms, etc.

CR-5 : Here most of the executives covering all the groups have agreed with the statement that most people have a tendency to become dependent and passive and that is why they feel helpless. Only 25 - 30% of the young executive having experience of not more than ten years (Table-5) have differed with the statement. Response from the majority respondents develop a resource myopic attitude which inhibits innovative and divergent activities and risk-taking.

A common practice in organisation life is that a sucess is rewarded and a failure is punished.Therefore, some individuals develop an exaggerated fear of failure and they are likely to avoid competitive situations and prefer to participate only in those activities in which one is reasonably sure of winning. CR-4 and CR-5 are the two items mentioned above relating to this aspect.

CR-6 : It shows that mostly the young/junior executive (Table-5), irrespective of their qualification do not agree with the statement that they prefer to participate only in those activities in which they are reasonably sure to win. Nearly 30 to 37% of the senior and middle-level executives have agreed with the statement.

CR-7 : While responding to this question 35 to 40 % of the executives covering all the groups have agree with the statement that fear of becoming failure goads a person to make a better and more focussed effect towards any task.Nearly 32% of them (Table-2) have disagreed. Others have remained undecided.

From the responses to the above two questionnaire-items(CR-6 and CR-7), we have found that nearly 53% of the respondents (Table-2) do not agree with the statement that they prefer to participate only in those activities in which they are sure to win. But more than 31% of them think so, which is a definite symptom of developing a fear of failure. Nearly 38% of the total respondents have been suffering from this fear of failure, whereas more than 32% of them are free from this fear and the others have not expressed their mind. In a mild form, fear of failure galvanises a person to make a better and more focussed effort regarding a task. But in its worst form, it can prevent one from taking risks and getting involved in activities in which one initially has low skills. This impedes divergent thinking and activities. A positive sign that I have noticed is that a majority of these executives are not suffering from a fear of failure and they are ready to face challenges.

CR-8 : Analysis shows that (Table-3&4), a large number of young and middle-aged executives (more than 70%) covering all the qualification groups do not agree with the statement that they always like to keep themselves away from the creative efforts due to some ambiguities involved, whereas 24% of the senior executives (Table-5) have agreed with the statement -- a negative sign vis-a-vis creativity.

Excessive spoon-feeding, over-structuring of thinking and routinised life, inter alia, cause one to become allergic to ambiguity and that makes a person shun the paths of invention, discovery and creation. More than 70% of the respondents have answered that they do not like to keep themselves away from the creative efforts simply because of some unaviodable ambiguities involved therein. It is also a positive sign for increasing individuals' creative efforts.

We know that various environs profoundly affect our traits, abilities, attitudes and behaviour. An environment shapes, if not determines, an individual's creativity in various ways, and influences him in developing or not various creativity-related abilities. Besides shaping personality, the environs may block or facilitate creative activities themselves. The respondents have been asked whether the environs of their respective organisation/departments favour creativity or not.

CR-9 : Analysis shows that, majority of the executives (more than 80%) irrespective of their age, qualification and experience (Table-2), do not think that the atmosphere in their organisation favours creativity and only 12 to 15 % of them think so, which need no further interpretation and is definitely a poor sign for creativity.

CR-10 : Here, as responded earlier, more than 65% of the executives covering all the groups (Table-2) do not think that their organisations encourage them to persue their hobbies/interests. Nearly 30% of the senior executives (Table-5) have agreed with the statement. This is also a poor sign for creative environment inside the organisation.

CR-11 : Analysis shows that a large number of executives (more than 80%) covering all the groups (Table-2) have disagreed with the statement that their organisations are respective to new ideas. Only 10 to 12% of them have agreed with the statement. Again negative response for creative environment.

CR-12 : Here mostly the young and the middle-aged executives (Table-3) having 10 to 15 years of experience have differed with the statement that their organisations want their exectives to make use of new knowledge/skills acquired. Only 20 to 30% of them agreed with the statement. However, more than 35% of the post-graduate executives (Table-4) have agreed with the statement.

CR-13 : Here 42% of the young and aged executives (Table-3&5), have agreed with the statement that their organisation treats them as matured individual. On an average 36% of the executives covering all the groups (Table-2) have agreed with the statement. However a large number of executives covering all the groups have remained undecided.

CR-14 : Analysis shows that (Table-3), large section of the young and the middle-aged executives (85.7% and 81.9% respectively) are not getting the opportunity of participating in the process of formulating policy etc. (as against 53.5% of the aged executives). Nearly 76% of the executives (Table-5) covering all the experience groups, do not think that they have the opportunity to participate in a meaningful manner in the policy formulation process, which is definitely a poor sign for unlocking creative potential.

CR-15 : It shows that nearly 60% of the junior and middle-aged executives (Table-3) do not feel free to make changes in their departments. 37% of the senior executives feel free to make such changes. A good number of executives covering all the groups have remained undecided.

CR-16 : Analysis shows that more than 60% of the executives covering all the groups (Table-2) do no think that they are free to set their own performance goals, where as 15 to 20% of them have responded affirmatively.

A large number of executives do not feel that their organisations genuinely want their executives to make use of new knowledge/skills gained, which can stimulate an individual's creative urges. Only 35% of the respondents think that their organisations treat them as matured individuals. A majority of them have no opportunity to participate in a meaningful manner in the process of formulating policies etc., excepting some of the aged executives. The positive reason might be that most of them have reached the senior level and get enough opportunity to participate in the policy formulation process. These executives are also getting opportunities to make desirable changes in their respective departments. They are enjoying adequate autonomy and freedom by virtue of their positions in the hierarchy. But for the young and middle-aged executives it is certainly an adverse sign vis-a-vis creativity.

CR-17 : Analysis shows that nearly 45% of the executives covering all the groups (Table-2) do not think that they have developed any physical ailments due to excessive stress and strain in their work place. However, majority of them have remained undecided. 15 to 20% of them have agreed with the statement.

Excessive stress is an adaptive response to unsupportive working environment and that causes various physiological disorders like increase in heart-beat rate, blood pressure, etc., of an individual.

The analysis and interpretation of the data presented above, more or less, indicate that the environs in the Government departments are not helpful in unlocking the creative forces within an individual.

RECOMMENDATIONS

It is clear that the environs in the Government departments are not favourable for creative functioning, even if some of the executives are ready to face challenges and ambiguities. Following are some specific recommendations that are expected to help make Government departments more creative.

(a) Government should genuinely try to create a stimulating environment in its departments so that one can feel that there is something new to do, experience and know, and one is expected to undertake new tasks and respond to the challenges.
(b) Government should encourage and reward creative behaviour, innovations and experimentation.
(c) Top managements should not bring in fearfulness and defensiveness amongst the officers by premature criticism or evaluation. Because, that type of environs certainly discourage creativity and in which any new idea is quickly dismissed as half-baked, stupid, impractical or wrong.
(d) Government should attempt to restructure its organisations so that its executives could regularly get feedback from their superiors and are critically, but constructively, evaluated, in terms of their outputs of creative efforts and abilities to handle complex situations, by the superiors.
(e) Government should arrange for continuous and rigorous academic and technical training for its executives, preferably the trainers being the experts in the relevant disciplines.
(f) Government departments should be rich in terms of diversity and intellectual ferment with a view to encouraging creativity.
(g) Environs of the government offices should encourage freedom of thought and action, but should equally demand responsibility, accountability and effective performance.
(h) The policy-formulation process and the decision-making process should be decentralised to the extent possible.
(i) There should exist a good incentive system and an effective co-ordination system.

Moreover, for successful implementation of creative ideas, Government organisations require a culture of achievement, creative behaviour and knowledge-based decision-making. An authoritarian culture or the one in which people become very much dependent on their superiors or on the system is not conducive to creativity. Creativity implies widespread risk-taking, seeing and seizing of opportunities, improvisation, resourcefulness, etc., throughout the rank and file.

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WISDOM LEADERSHIP : THE KEY TO HOLISTIC HUMAN POTENTIAL MANAGEMENT

KANIKA CHATTERJEE

THE ANATOMY OF A CRISIS

In the infinite arch of time, the human race has witnessed an endless cycle of birth, growth and death in the course of the sacred journey of life. Like a forest with its profusion of life, the world as a whole system holds intense fears and fascination at the same time. There is an element of loss and despair for what is apparently dying and decaying. There is also an element of hope towards what is being born or might be born through the puissance of the regenerative force that emanates from human integrity, inspiration, intuition, imagination, and ingenuity. *The present paper is homage to this innate creative power of the human race that bears the seed of an efflorescence of human consciousness.*

It is widely held that the human race is at present in an interregnum of civilisation representing the twilight of 'sensate' culture (Sorokin, 1937-41). Humanity is poised to manoeuvre a 'paradigm shift' (Kuhn, 1962) or a 'turning point' (Capra, 1982) of civilisation to tide over a spiralling crisis of moral erosion, ecological damage, economic poverty and social disintegration. Over the last two centuries, which is a minuscule in the annals of time, the human intellect's predilection with the philosophy of materialism in an industrial paradigm, has engineered scientific developments with aplomb. In this context, Sri Aurobindo (1962, p.103) emphasises: 'Science has ...encouraged more or less indirectly both by its attitude to life and its discoveries another kind of barbarism, ... that of the industrial, the commercial, the economic age which is now progressing towards its culmination and its close. This economic barbarism is essentially that of the vital man who mistakes the vital being for the self and accepts its satisfaction as the first aim of life'. Human ingenuity has at once produced both dramatic and traumatic impacts upon the delicate web of life nurtured by planet Earth. What is more, the philosophy of science has upheld improvement of 'human skills as to means' to gratify 'human folly as to ends' (Russell, 1952) that are unimproved. Fact has all along dominated values, so that impersonal and value-free knowledge is detached from concerns of the social, ecological and spiritual well being

of life. Although '*sapien*' literally implies "wise", ironically, this is one thing that the *Homo sapien* has not aspired to be. The human being, in the course of his intellectual evolution, has been programmed with a lopsided design fault—excessive left-brain/logical growth in comparison with inadequate right-brain/intuitive development. Thus, the moral of scientific "success" is that the human race will urgently have 'to increase in wisdom as in knowledge' (Russell, 1952) to achieve greater symmetry of the power of the intellect. *This paper is a reminder that we live in a time of decision, being faced by the awesome human option of survival or destruction. Sure enough, the need for whole-brain, wisdom-based visionary leadership has never been so great.*

The human crises of our time are an outcome of the long-standing intellectual disaster arising out of the extant system of academic inquiry referred to as a 'philosophy of knowledge', whose basic intellectual aim is improvement of knowledge. It is strongly dissociated from life and its problems, and knowledge acquired dispassionately is applied to help solve our problems of living. This needs to be transformed into the 'philosophy of wisdom', a kind of rational inquiry that has as its basic intellectual aim, to improve wisdom (Maxwell, 1987, pp.3-4). The 'philosophy of wisdom' holds that, in order to provide rational help in realising what is of value inquiry must give absolute intellectual priority to our life and its problems, to the mystery of what is of value actually and potentially in existence, and to the problems of realising what is of value. The power of wisdom can enhance our capacity to repair the intellectual disaster that lies at the core of western thought, science, and education. Knowledge (*jñana*) and wisdom (*vishesh jñana* or *vi- jñana*) are inherently different from one another. Sri Aurobindo (1992, pp.3-4) clarifies that there are 'two allied powers in man: knowledge and wisdom. Knowledge is so much of the truth, seen in a distorted medium, as the mind arrives by groping; wisdom what the eye of divine vision sees in the spirit...what men call knowledge is reasoned acceptance of false appearances. Wisdom looks behind the veil and sees...' He further states that knowledge divides, fixes details and contrasts them, whereas wisdom unifies, and integrates contrasts in a single harmony. *This paper anticipates the arrival of an intellectual revolution from knowledge to wisdom in the evolution of tomorrow's leadership.*

In "*The Life Divine*", a path-breaking treatise on spiritual transcendence, Sri Aurobindo offers an intellectually precise classification of knowledge as shown in Exhibit 1. Clearly, the highest rung of knowledge i.e., knowledge by identity represents wisdom. According to Sri Aurobindo (1996, Chapter 2, p. 12): "Knowledge by Identity... cannot be reproduced successfully in the terms of thought and speech, but when we have attained

to it, the result is a revaluation of the Unknowable in the symbols of our cosmic consciousness ... which results in a revolution in our internal being, and through the internal, of our external life".

EXHIBIT 1

The Four Stages of Knowledge according to Sri Aurobindo

(Adapted from *The Life Divine, Book II, Chapter 10, pp. 524-25*)

KNOWLEDGE BY IDENTITY

[The original, fundamental way of knowing through a clear and distinct intrinsic awareness of the whole entity within]

KNOWLEDGE BY INTIMATE DIRECT CONTACT

[It starts with a secret knowledge by identity but is actually separated from the source; it is powerful but incomplete]

KNOWLEDGE BY SEPARATIVE DIRECT CONTACT

[It is supported by a direct contact or partial identity, but separated from the object of observation]

SEPARATIVE KNOWLEDGE BY INDIRECT CONTACT

[It relies on indirect contact and acquisition through the senses of sight, hearing and touch leading to imperfect documentation]

CAN BUSINESS COME TO THE RESCUE?

The intellectual revolution from knowledge to wisdom depends conspicuously on transformational leadership within the major social institutions including business and industry, academe, scientists, and governments, not forgetting the media. Transformational leadership as distinct from transactional leadership is able to articulate a realistic vision of the future for an organisation, so that it can grow out and improve upon the present (Robbins, 1997, p.455). It addresses the self-developmental needs of individual followers and can profoundly inspire them to transcend their limited self-interests for the good of the organisation and society.

Integrity, consistency, credibility, competence, loyalty, and openness are the hallmark of transformational leadership. *The present paper stresses that transformational leadership of business as the most dominant social institution of our time, can be vastly instrumental in enabling the world of intellect to turn the tide from a philosophy of knowledge to wisdom.*

Peter Drucker (1992, pp.113; p.116) observes that the more sceptical we have become about the behaviour of traditional leadership groups in society such as politicians, preachers, physicians, and lawyers, the more we have come to expect virtue from business and business people. He attributes the burgeoning interest in business ethics within business schools, in business itself, and in the media to the fact that 'the behaviour of business and business people has acquired a different meaning in the industrialised world', today. He explains that business executives are inevitably leaders in their organisations. In fact, they are seen, perceived, and judged as such. And so, what an executive does, believes, values and rewards is watched and interpreted all across the organisation, especially if there is a discrepancy between preaching and practice. Arthur Watson, ex-president of IBM, asserts in a similar vein: 'Providence was not whimsical when it chose business to bring the world together. People care about business; they may never agree about religion or ideology, but there is a logic to business, and through it we may see this quarrelsome, troubled world brought together' (Kinsman, 1992, p.58). Willis Harman (1988), too, has stressed, "business has become in this last half century, the most powerful institution on the planet. The dominant institution in any society needs to take responsibility for the whole".

Inspired by Drucker, Watson and Harman, the author initially posits that *business managers as organisational leaders should increasingly serve as society's exemplars for navigating humanity through the present evolutionary crisis and assisting in the elevation of the human consciousness to currently unknown levels* (Chatterjee, 2001, p. 119). For the purpose of the paper, we accept Peter Senge's (2001, p.54) definition of leadership that is simple, yet radically different from mainstream interpretations. The *abstract* version of his definition is that 'leadership is the capacity of a human community to create its future', while the *operational* version is that 'leadership is the ability of people in an organisation to initiate and sustain significant change, and to work effectively with the forces that shape change'. Thus, leadership is inseparable from *change* on the one hand, and *collective capacity* on the other.

Secondly, it is proposed that *business leaders of the future have to model themselves on "wisdom leadership"* (Chakraborty, 1999, p.82) *to serve as effective navigators* of the human race; holistic psychic wisdom instead of fragmentary vital knowledge must be the starting point of

leadership. Wisdom leadership is principle-centred leadership (Covey, 1990), since it is implanted in self-validating natural laws in the human dimension. These inviolable principles are real and ageless, including service, fairness, equity, integrity, honesty and trust. The degree to which we accept and espouse these self-evident principles that are deeply rooted in every civilised society and every enduring organisation, determines the chances of our survival and stability, or otherwise, disintegration and destruction. Thus, like a magnetic compass pointing northwards, an immutable, principle-centred core, is at the heart of wisdom leadership that enables us to change the way we raise questions and address the changing needs and opportunities around us.

Thirdly, contrary to popular belief, we surmise that *the basic impediments in this process of elevation of human consciousness, and in the development of human potential, lie within us and are not largely imposed by the external environment.* As Mahatma Gandhi said, 'we must *become* the change we seek in the world' to avoid the seven tools of self-destruction: wealth without work, pleasure without conscience, knowledge without character, commerce without morality, science without humanity, religion without sacrifice, and politics without principle. It is, indeed, a creative process of self-knowledge and self-mastery that makes us open and more amenable to change.

INTEGRAL MANAGEMENT : THE BASIS OF WISDOM LEADERSHIP

Historically, modern materialism has caused business philosophy to be focussed on external opulence leading to an overemphasis on the material body and the informational brain of an organisation as well as its human participants. The material body signifies the *primal* aspect born of the entrepreneurial revolution, whereas the informational brain represents the *rational* aspect arising out of the managerial revolution. The arrival of the design revolution during the close of the 20^{th} century has added a *humanistic* aspect to business, symbolising the emotional heart; consequently, caring for the customer (i.e., anybody who comes with a need to be fulfilled) and making qualitative improvements in human relationships came to be seen as the key to organisational excellence and world-class performance. Non-material dimensions of development such as quality of life (QOL) and a feeling of harmony came to be underscored in place of an exclusive quantitative orientation of performance in terms of material gain.

These three aspects of development in business philosophy have brought in their wake innumerable quick-fix solutions in the nature of

"three-letter success *mantras*" that seem to tantalise business communities everywhere. For example, business people unthinkingly pursue business process re-engineering (BPR), total quality management (TQM), just-in-time (JIT), supply chain management (SCM), customer relationship management (CRM), enterprise resource planning (ERP), activity-based costing (ABC), human resource management (HRM), *ad infinitum*. Consultants and the business academia constantly offer answers for doing "more-of-the-same" (MOTS), only faster and with fewer resources, to cure the lethal ailments of modern organisations, and to heal the wounded souls of the humans within them. Ironically, they do this even on realising that today's "*global problematique*" is a resultant of corporate myopia symptomatic in the cult of acquisitive individualistic personalities, the unbridled race for immediate results for short-term success where means justify ends, an all round ethical insensitivity of complacent managers, and a pervading impoverishment of our souls. Take, for instance, the concept of re-engineering. Hammer and Champy (1994, p.32), the high priests of BPR, define re-engineering as, 'the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in critical, contemporary measures of performance, such as cost, quality, service and speed'. Re-engineering is a classic example of "the answer" that does not deal with the question of the soul (Secretan, 1996, p.5). It conveniently proposes specific solutions for broad issues; indeed, it is very popular with those who manage by "fad-flitting" and the urgent need to "fix things". Fad flitting frequently fails to fix problems at the core because it does not fit the right questions; it does not address the emptiness of the human spirit, and what really ails us. All too often, it is the very reason of our current predicament.

The human predicament makes it imperative that we search our souls and seek the right questions; for, we do not need answers for gratifying the individualistic personality anymore. If we addressed "the question" before "the answer", we would probably realise that it is *not* "re-engineering" but "regeneration" of the soul that we need as a long-term sustainable solution. Regeneration implies spiritual rebirth, or energising with new life, especially after a decline to a low or abject condition. It ushers in integral or holistic management as a radically new wave of business development that will inspire a new generation of wisdom-based leaders. *Accordingly, integral management is the appropriate management framework that buttresses the thesis of this paper.* It symbolises the awakening of the inner spirit of the evolving organisation and the humans within it to transcend the intensifying crises of moral degeneration, ecological damage, economic disparities, and social disintegration (Chatterjee, 2001, pp. 119-121). Exhibit 2 shows the evolutionary pattern of integral management.

EXHIBIT 2

Evolution of New-Age Business

Phases of Business Development

Organisational Attributes	Primal / Entrpreneurial *(Material Body)*	Rational / Executive *(Informational brain)*	Humanistic / Enabling *(Emotional heart)*	Integral / Transcending *(Universal soul)*
• Development phase	Youth	Adulthood	Mid-life	Maturity
• Crisis leading to evolution	Crisis of control owing to complexity	Crisis of alienation and bureaucracy	Crisis of meaning and purpose	Crisis of ethical and spiritual vision
• Organisational identity & relationships	• Personal • Independence	• Corporate • Dependence	• Trans-corporate • Interdependence	• Global/Universal • Transcendence
• Organisational form	Pioneering, independent enterprise	Hierarchical, Institutional shareholder-represented public company	Self-renewing, enabling, reciprocating, networked architecture	Transcendent sanctuary with a creative spiritual force as the nucleus
• Leadership roles 1. Masculine 2. Feminine	1. Entrepreneur and dynamic hero 2. Animator and enthusiastic heroine	1. Authoritative business executive 2. Perceptive and flexible change-agent	1. Faithful and responsive adapter 2. Farsighted and co-operative enabler	1. Imaginative, original creator 2. Enduring, steadifast spiritual adventurer
• Managerial input for change	Instinct	Intelligence	Insight	Inspiration and intuition
• Organisational input for change	Enterprise	Order	Adaptability, quality and harmony	Vision, character and commitment

INTEGRAL MANAGEMENT AND THE MOVE FROM *HRM* TO *HPM*

Integral or holistic management attempts to understand socio-economic realities as integrated wholes with synergistic properties (The term "holistic" derived from the Greek word *holos* implies the whole). The basic assumption underpinning integral management is that all humankind and all of existence constitute a unified totality. By this token, the organisation is perceived as a unified system of people, who are the ultimate forces of creativity. Inherently, such an organisation is characterised as a "sanctuary" of missionary leaders and members. This new organisational configuration symbolises a community of souls (Secretan, 1996, pp 37-38); rather than a place, it represents a state of consciousness for renewing and integrating the soul. The enlightened dwellers of the sanctuary realise that the issues troubling people are reflections of what is likely to be found in their own personality, heart, mind and soul. They intuitively understand the value of unity of the universe, and that, all individuals are part of one universal and eternal soul. Thus, there is synchronicity of values such as contentment, peace, love, compassion, reverence and trust amongst them. The integrative process extrinsically connects each person with the whole, with one another, with all (vocal or silent) stakeholders, with the world society, and ultimately with Nature, in evolving patterns of relationships. Alongside, it intrinsically puts people in touch with their own souls, wills, wisdom, knowledge, visions, and emotions. When it comes to resolution of organisational crises, members do not re-engineer operations by putting people last; instead, they regenerate by putting people first.

Integral management embraces ethical, human, economic and technological solutions harmoniously, by upholding four pillars of excellence in work (Mitroff et. al., 1996, p.35), and by recognising the need to manage with integrity the synergy and conflict arising within these four dimensions. Interestingly, each of these pillars corresponds with the four pursuits that the ancient Greek philosophers had identified as individually necessary and collectively sufficient for the development of the human race.

I. **World service and spirituality** symbolises *beauty*, and stresses the question : How can we assist the promotion of harmony and well being of nature and humanity by contributing to the solution of global-scale problems? The pursuit of beauty is the *aesthetic* function of the organisation.

II. **Regeneration and development** symbolises *goodness*, and addresses the basic question : How can we assist the holistic (physical, mental, emotional and spiritual) development of our

employees and of the organisation? The pursuit of goodness is the organisation's *ethico-moral* function.

III. **Knowledge and learning** symbolises the ideal of *truth*, and addresses the basic question : What do we need to learn and know for making decisions that benefit all stakeholders, and for delivering better world-class products and services that lead to total stakeholder satisfaction? The pursuit of truth is the scientific and *technological* function of the organisation.

IV. **World-class operations** stand for the ideal of *pragmatism*, and address the question: How de we orchestrate and implement world-class operations that are progressively attuned to the Laws of Nature? The pursuit of pragmatism is the organisation's *economic* function.

Within the framework of integral management, the pivotal force behind organisational excellence is integrity. This is because the human mind is impotent without power, power is dangerous without vision, and neither is lasting or significant without the force of integrity that is embodied in a concern for the intergenerational continuity of organisational life. Integrity represents an insightful ascent to the construction of human values by integrating with inviolable principles; its presence involves a chain of consistency between vision and action, espoused values and practised values, word and deed; therefore integrity fosters trust. As a way of knowing and thinking, it represents the pinnacle of human development and the highest form of human intelligence. It is a synthesizing form of thought that acts to preserve the whole by accepting polarities, appreciating differences, and finding connections that transcend and encompass all points of view.

Thus, when integral management is practised within a sanctuary-type of organisation, the quality of human development is of paramount importance. Managing human beings assumes a more sublime task than the popular concept of human resource management (HRM) envisages. HRM provides a blinkered view of human beings by demeaning their superior mental faculties and construing them as resources to be administered, used (if necessary, through coercion), manipulated and exploited. The prospect of self-management for realising innate human potentialities is undermined. HRM fails to stress the aspect of humans as having superior mental development, the power of moral reasoning and articulate speech, and the capacity of spiritual evolution, in contrast with other living beings, and additionally, the quality of sympathy and fallibility as compared with machines. Casse (1994, pp. 23-6) maintains that it is ethically wrong to equate people with the term "resources". People very often resent being described in these terms. The expression HRM befits

the century-old command-and-control, hierarchical organisational structure. Here, in a typical military style, HRM relegates people into the category of corporate resources, and implies that companies employ people to utilise them efficiently for promoting the foremost corporate mission of producing and selling goods and services to earn profits. HRM confines leadership to a narrow model of "dealership" (Chatterjee, 1998) since a leader is viewed as one who deals astutely with resources, both men and material, perhaps even men as material. HRM in no way demonstrates that the raison d'être of all human work is the experience of delight, fulfilment and perfection through a sublime sense of commitment and service.

The sociological evolution of enlightened "knowledge workers" within a knowledge economy has necessitated the substitution of the traditional concept of HRM with a more appropriate concept of *human potential management* (HPM) that presumes an organisation modelled like a symphony orchestra. Drucker (1992, p.329), who coined the term knowledge workers in the 1960s, notes that these workers who increasingly make up the work force 'are not amenable to the command-and-control methods of the past'. Knowledge workers are inclined to resent manipulation all the more due to their superior intellectual skills, enhanced learning and creative capabilities. Rather, they would progressively expect a sanctuary-type of organisation with wisdom leaders enabling (rather than disciplining) creative people to develop and realise unconditionally their true potential as human beings. As Casse (1994) points out the 'knowledge partner (not employee) cannot simply be treated as a piece of equipment that the company and its senior executives move around according to their needs'.

The underlying premise of HPM is that human beings by nature are full of energy, capable of independent thinking, and equipped with superior mental abilities. Hence, they are capable of being proactive and their latent energies can come into being. By using their potential, human beings are capable of taking charge of their own selves. They need not be reactive to, or directed by external influences; external influences could actually thwart potential in many cases. Thus, modern-day organisations have to look beyond salary, comforts and expectations as motivators for their knowledge partners to work and grow. They will have to create conditions conducive for nurturing creative and innovative autonomy, so that people can achieve their full potentialities. In doing so, there would be a triple benefit: individual workers would evolve holistically as better self-developed human beings; the organisation would get closer to achieving its strategic goals, and the quality of human consciousness in the world society would ascend to a higher level.

The idea of HPM, thus, crystallises into an integrative process of enhancing human capabilities and capacities, through enrichment of human beings' existing potential and inspiration for discovery and realisation of their latent potential. This will be effected through micro-level human development interventions, and macro-level systems interventions that can create and sustain an enabling environment whereby individuals may achieve their full potential to individual, organisational and social advantage. HPM has a number of distinctive features that set the stage for an efflorescence of wisdom leadership. These are, *inter alia* :

- It represents a significant step in a continuum of the evolving process of business management.
- It is based on an underlying belief that each human being has immense, multidirectional potential, both existing and latent.
- It advocates that a human being but must be viewed holistically in terms of interrelated physical, mental, vital/emotional and spiritual attributes, instead of a resource.
- It focuses on self-development, self-management and self-mastery, because it implicitly assumes that if human beings are provided with opportunities to use their potential, they can manage themselves. There is no need to manage them via external controls so they may be utilised for attainment of organisational objectives.
- The fundamental purpose is to turn employees' potential to their own advantage, thereby leading automatically to the organisation's advantage, and ultimately to the benefit of the world society at large.
- It can be meaningfully implemented only in a dynamic environment that allows continuous updating of organisational policies, structures and systems so as to enable employees to achieve their full potential and to contribute their best to the organisation. Thus, the challenge must be addressed with a "continuous development" mindset and not the "maintenance" mindset of HRM.
- It assumes that in problem solving, the *sukshma* or subtle element (i.e., the quality of mind, aesthetic and ecological awareness, creative interpretation) is more important than the *sthula* or the perceptible element (i.e., data, information, and quantitative measurement).
- Motivation for work is largely self-directed through mind enrichment and development of one's latent internal energies; inspiration in work is derived from *ananda* (creative delight) and

mukti (autonomy), the two supreme goals of all work according to the *Upanishads*.

THE QUINTESSENCE OF WISDOM LEADERSHIP

The evolution of integral management with HPM as a basic desideratum creates the need for a new type of business leadership that can create an ambience for the holistic development of all organisational members, including their own selves, as whole beings. The new breed of leaders shall take up the task of awakening organisations and their members to transcend their limited consciousness. They shall arrive as effulgent spiritual forces, and many may come from other walks of life, from outside corporate life altogether (Koch and Godden, 1996, p. 228). More than culture and information technology, they will perform by the force of their own values, character and personality. This emergent approach to organisational leadership is what we have earlier referred to as wisdom leadership or principle-centred leadership. Wisdom is the essence of leadership in a sanctuary. It unites knowledge based on reason and information with intuition, inspiration and action; it requires an understanding of the organisation and all its elements as systemic wholes.

Wisdom leadership epitomises the synthesis of rationality and intuition as complementary modes of consciousness and functioning of the human mind, to yield dynamic creativity. According to Indian philosophy this is intellect or *buddhi*: the unity of faith-reason-will that humans can develop out of their neuro-psychic energies as a part of nature's endowment. Sri Aurobindo (1956, p. 24) maintains that the intellect is an organ composed of several groups of functions, divisible into two important classes: the functions and faculties of the right-hand that are comprehensive, creative and synthetic, and the functions and faculties of the left-hand that are critical and analytic. *Buddhi* integrates *yukti* (the analytical power and clarity of grasping facts), with the creativity of *shraddha* (the richness of faith and sensitiveness of values), and adds to this *dhriti* (the power and dynamism of pure will). To be sure, *shraddha* without *yukti* is blind, just as *yukti* without *shradhha* is sterile and ineffective. Contrary to the popular misconception of the term as depicting a narrow, logical intellect, *buddhi* truly represents the faculty of whole-brain thinking, which is representative of global vision, and luminous, creative and dynamic reason. The application of *buddhishakti*—the full power and perfection of the purified *buddhi*—can lead to potential scientific and spiritual discoveries, creation of art and music, and to a fulfilment of individual and collective life (Swami Ranganathanananda, 1988, p. 165).

The quintessence of wisdom leadership is the willed transformation in the consciousness of the leader that gives her a new standpoint for action. There is a progressive refinement, expansion and ascent of the lower bestial self towards an all-pervading, transcendental, higher Divine Self. In the adventure of consciousness that wisdom leadership involves, the *Gita* (by far, the most authoritative treatise on leadership ever documented) provides solutions to life's problems that are true for everybody and for every kind of human work, *sarvakarmani*, and any activity can be performed as a field of work for the practice of the spirit of the *Gita*. Sri Aurobindo (1970, pp. 670-71) underscores the significance of the *Gita*'s message in regard to its applicability to business: 'It is in his (Sri Krishna's) view quite possible for a man to do business and make money and earn profit and yet be a spiritual man, practise *yoga*, have an inner life'. The *Gita* provides the 'sole entirely true solution' to the problems of human existence which is 'to rise above our natural being and normal mind, above our intellectual and ethical perplexities into another consciousness with another law of being and therefore another standpoint of action...'(Sri Aurobindo, 1993, pp. 238-9). The *Gita* urges a leader to "do works regarding (also) the holding of the peoples" not merely as a social ideal but as an ideal of progress towards dynamic spirituality that is integrated with the main-stream of life: "*lokasam graham evapi sam pashyan kartum arhasi*". Dynamic spirituality, as opposed to sterile asceticism, symbolises the advancement and evolution of the life of the people by a leader-exemplar, through an awakening of spiritual consciousness or *cetayanti*, for a highly developed performance of action, which is echoed in the phrase *yogah karmasu-kaushalam*. To this end, the *Gita* enjoins on the leader-exemplar to restore *buddhi* or enlightened reason, as the guiding force and charioteer of the chariot of life—"*buddhau sharanam anviccha*"—'put life under the guidance of *buddhi*'. This human faculty is kindled not by sensory perceptions but by a puissant light that emanates from the pure consciousness of the Supermind, through the practice of Integral or *Poorna* Yoga as explained in the *Gita*. Integral Yoga represents the confluence of *jñana* (insightful knowledge), *bhakti* (divine love), *dhyana* (deep meditation), and *karma* (dedicated action). The first step is *Karmayoga*, which implies the selfless sacrifice of works with an emphasis on action. The second is *Jñanayoga*, where the insistence is on knowledge, and the third step is *Bhaktiyoga*, where the insistence is on devotion (Sri Aurobindo, 1993, pp. 34-5).

The *mahavakya* of the *Gita* 'resolves itself into three great steps by which action (that is emancipated from imperfections of the lower self to a higher law) arises out of the human into the divine plane'. It has all along justified works as an approach to practising Integral Yoga that enjoins the

practice of Yoga of Work (*Karmayoga*), Yoga of Devotion (*Bhaktiyoga*) and Yoga of Knowledge (*Jñanayoga*). The essence of *Karmayoga* is that all acts are included in action. It is the consciousness and inner attitude in which work is done that is important, even though the outer form may vary greatly according to *svabhava* or varied natures. Work is action oriented towards a fixed end and done constantly and methodically; moreover, this fixed end should be primarily a spiritual or psychic motive (instead of a grossly vital one) of offering one's work as a sacrifice—*yajña*—to the Divine.

Unlike skills and technology, spiritual consciousness cannot be effectively borrowed, imported, transferred or even taught. It must be learnt, practised and lived through an arduous process of universalisation of one's own consciousness and the divinisation of the inner and outer being through the practice of Integral Yoga. This proceeds with an ardent and steadfast aspiration for attaining self-perfection, and a relentless rejection of one's obstinate lower nature that can impede spiritual progress. Celebrated management theorist, Warren Bennis (1994, p.7; p.361), echoes this veritable truth about new-age leadership: 'Doing business in the new paradigm starts with managing yourself' because what characterises a new-paradigm manager is 'leadership and self-mastery, intuition and vision'. Integral Yoga will guide the wisdom leader not only to ascend in consciousness but also to bring down the lights and powers of the higher planes into the lower spheres of consciousness so as to join both the higher and the lower. More importantly, it helps develop the following distinct capabilities that are indispensable for wisdom leadership.

- *Holistic thinking* : the ability to view individuals, organisations, and their environments in entirety.
- *Reflective-ness* : the ability of critical introspection on a regular basis in order to understand how one's decisions and activities impact the lives that are touched.
- *Inside-out Dynamic* : the ability to delve inward to develop personal authenticity through congruence of values, principles, behaviour and action, and move outward to create value through environmental care, simple lifestyles and loving relationships.
- *Congruence of Values* : the willingness to align espoused values with the values that are practised in order to build trust, credibility and integrity.
- *Decency* : the ability to make and implement decisions through inspiration, compassion and respect instead of demeaning the human beings served.
- *Judgement* : the ability to compare, weigh, understand, and decide serenely without revealing the source and nature of spiritual awareness.

- *Moral Courage* : a constant willingness to pay a price for acting on principle even when that conflicts with economic and social benefit.
- *Optimism* : the ability to see opportunities in the face of mounting crises.
- *Emotional Intelligence* : the ability to recognise and deal with inner feelings and thoughts in a complete manner, to understand one's impact on others and how to deal with their feelings.
- *Ethical Sensitivity* : an awareness of the interplay of masculine and feminine mental forces within oneself, and a reorientation of values that the feminine represents.

To summarise, we may say that wisdom leadership starts as a journey of spiritual self-discovery within oneself, and it emerges when vision, energy, decisions, actions, and relationships are informed by values that acknowledge the sacred element of all life (Chaleff, 1998, p. 9). In terms of its inherent qualities, wisdom leadership is variously described as values-driven (Badaracco and Ellsworth, 1989), spiritual (Chaleff, 1998, p. 9), enlightened (Oakley, 1998, p.11), animated (Spitzer, 1999, p.13), moral (Holden, 2000) and inspirational (Burns, 1978). Wisdom leadership prompts a new set of activities, priorities and roles to enable integral managers to develop a truly global world-view and a planetary allegiance.

THE MYSTIQUE OF THE WISDOM LEADER

A very basic question that we must address: Who is a wisdom leader? A wisdom leader is one who aligns conscious choice with the energy to manifest that choice as a daily mode of living.

Unlike efficiency-driven, bottom-line managers, consciousness-driven wisdom leaders have their roots in an invisible and strong spiritual core (as shown in Exhibit 3 below). Chakraborty (1999, p.86) observes that wisdom leaders in world history have all been characterised by the power to lead their own lower self by their awakened Higher Self. The lower self or *vyavaharika vyaktitwa* is the perpetually hungry, empirical part of our being that works on the surface; the Higher Self or *paramarthika vyaktitwa* is the in-built permanent core of *poornatwa*, deep in slumber within our being.

The wisdom leader arouses this dormant Higher Self where dignity and selflessness are inherent, to lead and guide the active lower self that is clouded by the meanness and ugliness of desire or *trishna*. Being powered by the process of inner silence and solitude as a way to invigorate her consciousness of the Higher Self, a wisdom leader aspires to imbibe the timeless and universal message of the *Gita* into every aspect of her

EXHIBIT 3

Bottom-line Managers versus Wisdom Leaders

Nature/Role	Bottom-line Managers	Wisdom Leaders
• are concerned with	Goals and objectives/ Administration	Vision/Creation
• give precedence to	Expediency	Integrity
• work with	Priorities, structures and systems	People, relationships and values
• create	Plans and strategies	State of mind
• focus on	Getting	Giving
• manage	Human effort (physical and mental)	Human energy, heart and spirit
• favour	Maintaining	Developing
• are inclined to	Accept the status quo	Challenge the status quo
• improve with	Imposing control; performance evaluation	Instilling trust; acknowledgement of contributions
• perform for	Problem-solving and decision-making	Inspiring with example, guidance and values
• ask	How and When	Why and What
• view	The short range of the bottom-line	The long-range of universal well being
• are driven by	Efficiency and the bottom-line	Quest for attaining higher level of consciousness

EXHIBIT 4

Quality of the Mind or "*Guna*" as Determinant of Type of Leadership

Quality of Mind or "*Guna*"	Driving Force	Leader Typology	Dominant Self-Orientation
SATTWIC	"*Manas*" or intuition and "*anubhuti*" or positive emotional feeling for welfare of all	Visionary, intuitive, holistic, wisdom leader	Self-realisation; spiritual-ethical perfection; nurturing motherhood
RAJASIC-SATTWIC	"*Buddhi*" or intellect and "*anubhuti*" or positive emotional feeling for social/ collective interest	Social activist or reformer	Self-sacrifice; concern for others
RAJASIC-TAMASIC	"*Buddhi*" or intellect for self-interest	Typical professional manager	Self-actualisation fuelled by self centredness
TAMASIC	"*Ahankar*" or ego for minimum critical effort	Manager with low drive	Self-indulgence

being, *sarvabhavena*, within and outside the workplace. Silence plus solitude produce the "*rajarshi*"—the quintessential Indian model of the wisdom leader. It symbolises the principle of 'sacro-secular symbiosis' or S^3. *Raja* represents the secular arm and *rishi* the sacred arm of the model. In terms of quality of mind or *guna*, the *rajarshi* leader epitomises the *sattvic* quality of harmony and equilibrium seeking. In contrast, the typical professional business manager represents a mix of *rajasic-tamasic* qualities. We present in Exhibit 4 the principal aspects of different personality types based on *guna*, to drive home the difference between a wisdom leader and the efficiency-driven manager.

EXHIBIT 5

Multiple Roles of a Wisdom Leader

Role Descriptor	Role Description
Yogi	Managing one's own state of mind in terms of qualities such as contentment, capacity of acceptance, equanimity, and detached involvement.
Servant	Giving spontaneously as a way of life arising out of a sense of caring—giving whatever the situation demands with no strings attached, so that leadership becomes an act of love, compassion and sacrifice.
Guide	Seeking to liberate the creative energies in people, inspiring a constant spiritual awareness in them, and enabling them to rise towards their higher psychic being.
Inner warrior	Being able to hold out against society's pressures through the strength of an inner truth that impels action, and subsequently showing others the way. As a warrior, the leader is not destructive but is a free spirit with an unbending intent.
Whole-maker	Knowing and ushering into the organisation a deep sense of community and teamwork born of a spiritual truth of the cosmic oneness of all life.
Sense-maker	Defining reality by learning and listening to the aspirations of stakeholders, in order to enhance the meaningfulness of organisational purpose and to make sense of the organisation in the context of an economic biosphere.
Optimist	Instilling in the organisation an aura of confidence, right thinking, great capacity for action, a bold stepping out when others hesitate, and a belief that positive thinking is the true source of power.
Moral architect	Making integrity workable in a human system by creating congenial conditions in which people can develop holistically and always keep good company.

Leadership performance depends upon the state of mind, which according to Indian wisdom is threefold—*sattvic* (or illumined), *rajasic* (or dynamic), and *tamasic* (or inert). *Sattvic* qualities in the wisdom leader will enable a blending of multiple roles (Exhibit 5, p. 194) in her personality (Hawley, 1993) :

INSPIRATIONAL MOTIVATION : THE SUPREME TRANSFORMATIONAL TASK OF A WISDOM LEADER

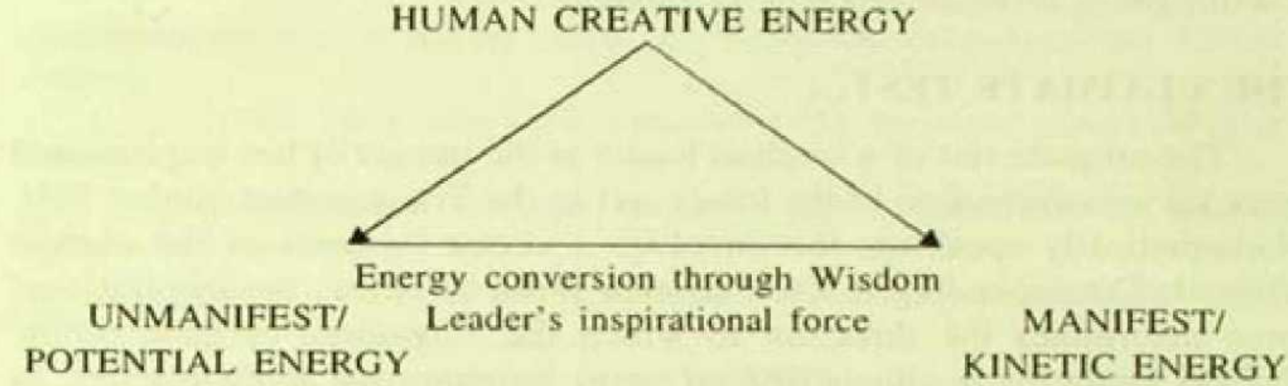
Chapter 3 (*slokas* 25-26) of the *Gita* specifies the following rule: 'as those who know not act with attachment to the action, he who knows should act without attachment, having for his motive to hold the people—*cikirsur lokasamgraham*. He should set them all to actions doing them himself with knowledge and in *Yoga* (Sri Aurobindo, 1993, pp. 128-9). Within a framework of the sanctuary type of organisation where *sattwic* type of culture is prevalent, people are self-motivated and experience freedom and joy in their work situations. This culture creates conditions conducive for self-fulfilment of employees, as work itself becomes a mode of worship in the practice of *Karmayoga*. Under these circumstances, the traditional theories of human motivation emphasising needs as the fountainhead of motivation will not work because wisdom leaders and their followers within a sanctuary are greatly inspired by the higher order values in life that can become a conduit of creative energy. Since "needing" is at the core of the need-based theories of motivation, they implicitly induce proliferation of needs (Sharma, 1996, p.122). For example, Maslow's conceptualisation of "self-actualisation" as the highest order need is almost always associated with self-interest and self-concern. A self-actualising personality can be exceedingly selfish, may have no higher motives, may parade one's own power and be quite self-satisfied (Assagioli, 1974, p.17). Self-actualisers, very often, tend to be insecure, anxious, fearful and distrustful. In fact, self-actualisation tends to unleash selfish, self-aggrandising, dehumanising and aggressive tendencies in a person (Geller, 1982, p.58). Thus, the western, need-based motivation theories oriented towards the typical acquisitive individualistic personality, cannot rightly capture the *sattwic* orientation of a wisdom leader. An alternative conceptualisation is to construe a basket of NEEDS (the word is used as an acronym) comprising Necessities, Entitlements, Empowerment, Desires and Self-realisation. The size of this basket may vary across individuals, and individuals can exercise self-control or *sanyam* over the size of the basket through the practice of Yoga, so that the "basket of NEEDS" does not become a "burden of needs", which unfortunately, is a major affliction

of modern societies and organisations. In the perspective of the Upanishads, the transformational journey of an elevation of consciousness from self to Self may be explored in terms of the psycho-philosophical theory of "*kosa*" or sheaths or planes of our being. In this regard, the basket of NEEDS belongs to the level of *annamaya kosa* or gross physical body of the self. According to the "*kosa*" theory, the human entity is conceived in terms of five successive sheaths—the *annamaya kosa* or gross physical body made up of food concerned with physical needs, the *pranamaya kosa* or the vital plane concerned with imaginative, subjective and emotive satisfaction and pleasures, the *manomaya kosa* or the mental plane concerned with intellectual and aesthetically satisfying activity, the *vijñanmaya kosa* or the intelligence/wisdom plane concerned with the psychic and spiritual domain of human consciousness, and finally, the *anandamaya kosa* or the psychic plane of Divine Bliss. Each of these sheaths is a reservoir of energy and the source of the innate spiritual power or *atmikshakti*. By superimposing the NEEDS framework within the *kosa* framework, we can bring into focus a new concept of motivation, namely, inspirational motivation.

Inspirational motivation may be described as motivation arising from an inspirational vision that has the power to pierce through various *kosas* or sheaths of the human being, and thus release the flow of *atmikshakti* within. Here, motivation is considered to be a direct derivative of inspirational force on the one hand, and also derived indirectly through the inspirational force, by an alteration of the basket of NEEDS. Inspiration, not needs, is given primacy here. People tend to alter their basket of NEEDS according to the source and requirements of inspiration. Sometimes, they are willing to give up even their basic existential needs in order to translate the inspiration into action.

The concept of inspirational motivation rests upon the assumption that human beings are naturally endowed with immense energy that exists in two forms : unmanifest potential energy and manifest kinetic energy. Unmanifest energy exists hidden within the reservoir of the various *kosas* or sheaths. Inspiration provides the push to transform unmanifest potential energy into kinetic energy or the drive, and thereby releases an effusion of *atmikshakti* within a human being (Exhibit 6).

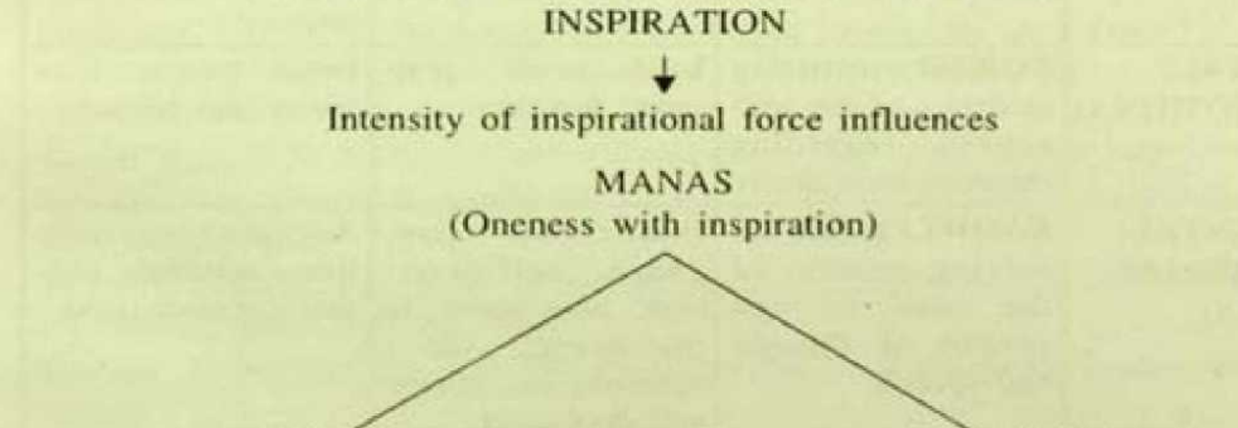
EXHIBIT 6
The Process of Inspirational Motivation



Therefore, the intensity of the wisdom leader's inspirational force is a determinant of the rate and quality of energy transformation, and depending upon the energy conversion coefficient, individuals differ in the intensity of their drives. This is why inspiration can lead to an alteration in or reorganisation of the NEEDS structure.

Again, the intensity of a wisdom leader's inspirational force depends upon a spiritual vision of the cosmic oneness of life, a constant willingness and ability for life-long learning, a transformation of the inner being through a process of sublime aspiration for self-restraint, self-mastery, and self-perfection, and capacity for example and precept based on the notion of sacredness of life. Furthermore, the intensity of the inspirational force depends on the interplay of three elements (Exhibit 7):

EXHIBIT 7
The Tri-dimensional Impact of Inspiration



- *manas* (intense desire to be one with the inspiration),
- *anna* (material conditions and NEEDS structure) and
- *prana* (energy or life force).

Many a time, people with poor material conditions achieve exceptional results because of the strength of the two other elements, which cause a willingness to make changes in *anna*.

THE ULTIMATE TEST...

The ultimate test of a wisdom leader is the impact of her inspirational force for transformation of the lower self to the Transcendent Higher Self. Mathematically speaking, this involves a vector in terms of the change effected. Corresponding to each *kosa* or plane of being, the inspirational force determines the *direction* to which the *magnitude* of each of the NEEDS category is channelled so as to heighten the strengths and to eliminate weaknesses within the leader as well as the led. The direction of change is both upward and inward as we see in Exhibit 8. In fine, it is through this sublime force of inspiration that the wisdom leader as pathfinder helps achieve the pinnacle of human potential for holistic human quality development.

EXHIBIT 8

Inspirational Force and the Direction of Self-transformation

Developmental Need According To "*KOSA*"	*Directed by a Discipline or "TAPASYA" of*	*To avoid Degeneration into*	*Towards a Path of Evolutiontowards*
* PHYSICAL	***BEAUTY*** : involving austerity of physical life regarding food, sleep, exercises and work	Greed; gratification; inertia; laziness; pettiness; resistance to change	Harmony of posture, beauty of form, agility in movement, resistance in health, and prowess in activity
* VITAL/ EMOTIONAL	***POWER*** : involving austerity of the sensations regarding freedom from desire	Lust; pride; jealousy; hostility	Inner peace, harmony and serenity
* MENTAL/ INTELLECTUAL	***KNOWLEDGE*** : involving austerity of the mind through control of thought and speech	Intellectual arrogance; self-assertion; attachment to preferences, ideas, opinions and habits; self-deception	Acceptance; intuition; wisdom; cosmic consciousness
* PSYCHIC/ SPIRITUAL	***LOVE*** : involving austerity of feelings through *nishkama karma*—a rejection of all emotional attachment and working with a sense of detached involvement	Sterile spirituality; asceticism and world-shunning	Dynamic spirituality; truth-seeking and attaining perfection in work-life

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SUPPLEMENTING COLLECTIVE BARGAINING WITH PARTICIPATIVE [SOCIAL] DIALOGUE IN THE CONTEXT OF GLOBALIZATION

RATNA SEN

INTRODUCTION

Globalisation and liberalisation, with their attendant consequences of increased competition, technological change, workplace innovations and enterprise restructuring have put management and labour under tremendous pressure. This has been an era of vast changes: where old businesses have faltered or somersaulted or died; new ones have emerged overnight and raced to the top of the share charts, only to fall again; local enterprises have metamorphosed into multinationals; and old multinationals have taken on hardly recognisable identities. All kinds of realignments have turned the corporate world into quicksand. Stock exchanges have been fluctuating wildly, making and unmaking individual and corporate fortunes overnight. Hence, a very large degree of uncertainty pervades the world of business and not even the macro economic returns indicate clear trends.

While management has to look for new ways to remain afloat, workers and unions have to learn to cope and adapt to the changes being forced on them. Two major casualties have been protected domestic economies and large public sectors – panaceas for several developing economies. These have been replaced with liberalisation and privatisation. The initiative has certainly shifted to management, and industrial relations has become vastly more complex. The problems are no longer confined to negotiating on wages, allowances and working conditions. Employment, reorganisation, rationalisation, training and so on, have almost crowded out the conventional collective bargaining issues.

Developing countries, with their large workforces, income inequalities, and lack of access to organised employment and training, have been affected seriously by these problems. South Asia in particular with high concentrations of population, unemployment and poverty, has major challenges to face. In the countries of the region, over 90% of the workforce is already in the unorganised sector, and globalisation and liberalisation have increased this innate tendency. Organised sector employment is being further reduced through labour rationalisation. At the same time, the institutions of labour management relations are confined

largely to the organised sector. The role of the state is changing from that of partner to that of regulator and arbiter. Even that role is being usurped in some cases by international agencies, particularly the agencies that control international capital.

Unions reacted by protesting. Privatisation has been a particularly contentious issue. Public sector employees, for very long used to a comfortable non-demanding work culture, have taken to the streets in large numbers and under the banner of several combined union forums. This has been particularly true in India, which had a large dominant public sector. Within the organised sector, at the enterprise level, employers and employees are faced with major challenges and dilemmas. Obviously there is conflict in perceptions, and confrontation over methods. The choices facing unions are not easy. Do they campaign for higher pay for their remaining members or trade it for employment for their redundant members. Do they plead the case of acquired employees or defend the rights of their original members. Do they fight for the rights of casual or contract employees or protect the jobs of permanent members.

LABOUR MANAGEMENT RELATIONS

It has, therefore, become imperative to look for innovations and alternatives in labour management relations as well. The traditional relations and balance of power between the three actors – state, business and labour – have been seriously affected. Either bipartism has replaced tripartism, or power has shifted from labour or government to business, or uneasy temporary alliances have emerged among the different groups. New groups have also entered the arena of industrial relations. For instance public opinion and the consumer has begun to play much more important roles in industrial relations. The question being asked now, is whether collective bargaining can meet the requirements of the new situation. Or is it necessary to look for new ways to bring management and labour together.

Ironically, all the countries of South Asia have some form of collective bargaining. For instance, under **Bangladesh** law, there is provision for electing a collective bargaining agent [CBA] and for negotiations on wages and working conditions. But unionisation itself is not very widespread, nor is the labour movement very strong. All organised sector enterprises in **India** have a long history of collective bargaining as well as considerable exposure to consultative methods of workplace relations. **Nepal** has a system of appointing Collective Bargaining Agents [CBA] in the organised industrial sector. **In Sri Lanka**, dialogue between top management and

union leadership is common in the larger enterprises, with industry level bargaining in some cases, such as plantation sector. In **Pakistan**, bargaining agents are selected through secret ballot,

But collective bargaining does not cover more than 5-6 percent of the workforce in most of these countries. In many of them, the institution is not even fully matured or firmly established. In some it is still developing. Nor is the right of association widely acknowledged. While bargaining agents may be selected through secret ballot, bargaining itself is skeletal and does not cover many important issues, such as employment. Or even if substantive bargaining is well established, there is still no national legal provision for naming the bargaining agent in India. While the institutions of conciliation and adjudication have found it difficult to cope with such issues, the history of delays [4.5 years, according to Sivananthiran & Venkata Ratnam, p. 78] in adjudication make them even less appropriate.

If one considers also the sort of issues that are increasingly emerging on the industrial relations scenario, it is obvious that more flexible processes than collective bargaining are required to deal with them. More complex issues, and more complicated situations call for adaptable systems of discussion, not the typical demand-deadline-work stoppage-capitulation cycle that constitutes collective bargaining in most cases. The issues go beyond the traditional two parties typical of collective bargaining. Many more groups are involved. Neither unions nor management can trade off these issues against higher wages or lower employment. Even the relatively simple problem of re-deploying employees, after large cuts in workforce, is better managed through discussions rather than bargaining.

Other constraints in labour management relations exist in these countries. Unions and strikes are banned in some sectors in Pakistan. Labour inspection requirements have been relaxed in certain states in India. All the South Asian countries except Nepal, have export processing zones where unions have either been discouraged or banned. At the same time, labour ministry weightage in government policy-making has diminished and the governments themselves in several instances, appear reluctant to intervene in industrial relations. The importance of central unions in policy making has diminished

Union innovations have also started. In a highly fragmented union scenario, unions have come together on common platforms to oppose privatisation. In Sri Lanka they have jointly tried to get through the Workers' Charter. In Bangladesh and Pakistan they have jointly fought for unionisation rights in EPZs, though without much success [Sivananthiran & Venkata Ratnam, p. 4]. In the transport sector, consumer complaints redressal cells have been initiated by unions. Some unions have also started

offering newer more personalised services to their members. But the instances are too few and far between. Unions are also faced by the lack of universality of basic labour standards. Not even all organised sector employers accept all the basic labour rights. A large and adverse labour market makes unions doubly helpless. The irony is that many of the countries have a laudable legislative framework. Implementation however, is weak.

As workforce flexibility and multi-skilling become urgent concerns, the state too has new approaches. It has begun establishing agencies or funds. The National Renewal Fund [NRF] for retiring and retraining public sector employees in India, the Skills Development Council in Pakistan are examples. But this is bound to shift emphasis from *collective bargaining to direct forms of communication, consultation and worker involvement.* The Social Agreement on Privatisation in Pakistan [Shivananthiran & Venkata Ratnam, p. 74] of October 1991 is an example.

It is expected that in such a situation, both employers' and workers' organisations will have to explore newer methods and attitudes. This is not going to be easy for two reasons. Both employers' and workers' organisations in South Asia are besieged by multiplicity and conflict of interests among themselves. Add to this the complication of limited union membership for workers of most industries, and the task becomes that much more difficult. Sri Lanka is the only country of this region to have about 20 % unionisation among the workforce. In others, union membership is much less. India has less than 3%.

There are other impediments to the process of consultation and participation also. One of the complaints of most managers against consultative or participative practices is the delay in decision-making. Concensus building takes time, something that they are not prepared to allow. Another complaint relates to loss of confidentiality in information sharing. These are in reality reflections of attitudes, which still do not accord unions equal status or worth.

PROJECT ON SOCIAL DIALOGUE

In this context, a labour management relations project [South Asia and Vietnam Project on Tripartism - SAVPOT] to promote social dialogue in five countries of South Asia and in Vietnam was started from 1999, continuing through 2000 and 2001, by the ILO and funded by the Norwegian government. Most of the enterprises in the organized sector in these countries already have unionization and negotiations. But the project was undertaken to enlarge the ambit of labor management consultation

within enterprises. Initially, the project would be aimed at various types of enterprises in each country. Later, it would try to progress into the national system, trying to make dialogue an accepted national method of dealing with all problems. The pilot phase was completed in mid 2001, and the project so far has provided glimpses of success.

The basic objective was to supplement collective bargaining with consultation or dialogue among management and labor or unions at the enterprise level to meet the challenges of globalisation and liberalisation. There had already been several attempts earlier by the respective states to introduce workers' participation in management over the years. Most of the schemes had failed due to employer hostility, trade union indifference and excessive structuring. It was therefore felt necessary to change the approach tried earlier, and introduce a flexible dialogue process in these countries.

The project was introduced in Bangladesh, India, Nepal, Sri Lanka, and Vietnam initially through the employers' federation[s], central unions and government officials. The project did not materialize in Pakistan due to the political problems. A different method was followed in Vietnam, which is excluded from this discussion. In each of the remaining four countries, a few enterprises were identified, which were willing to participate in such a project. These enterprises represented different industries, sizes, methods of production and degree of unionisation. Care was taken to include industries, which had been affected by globalization.

Employers approached for participating in the project, were initially skeptical about it, apprehending that this was just another form of participation, There was also a marked fear of upsetting the status quo and unleashing new labor demands through the process. But core groups were formed in each country, which had the task of persuading employers to participate and to follow up on the activities and progress made. The objectives were

- to create a willingness to consult,
- to provide the basics for designing unique consultation or dialogue systems,
- to provide a supportive network for continuation of the experience.

Social dialogue in the context of the project meant systematic participative communication, with all participants making some contribution for the solution. But the structure would be designed by each enterprise, depending upon its own requirements. This was to include both bipartite and tripartite dialogue.

THE METHODOLOGY FOR THE PROJECT

Strategies for the project were :

- Bringing several enterprises in each country together to learn to hold dialogue by practicing it, as well as learning from each other
- Developing and profiling innovative work and dialogue practices at the enterprise level,
- Developing and supporting social dialogue at the national level, identifying where policy interventions could assist workplace improvement,
- Increasing the participation of people usually excluded from enterprise dialogue, such as women in the workplace, so that their perspectives could be brought to bear on decision making.

The project also aimed at analysing the quality of the dialogue process.

Once the pilot phase started the main constituents of industrial relations systems – government officials, employers' associations, central trade unions and academics in each country - were requested to help in identifying about six enterprises from that country, which would then be selected as participants in the project. At the same time it was decided to have National Advisory groups for each country. The selection criteria had to ensure that a fair cross-section representing different industries in each country, were selected. These industries should have been affected by the globalisation process, and should be willing to participate in the project. Union as well as non-union enterprises were targeted. The enterprises would also have to agree to research and documentation on the process. While the selection criteria were uniformly applied to all the countries, small variations had to be made to accommodate country-wise peculiarities as well as logistical problems, like accessibility and nearness to major towns. This would make the enterprises accessible to project teams, to each other and allow the organisation of workshops. At the end of the identification period, the following enterprises (see table) were selected to become the participants for the pilot phase of the project :

The list indicated a fair range of enterprises, in various industries. The enterprises varied widely in size, nature of ownership, and year of establishment. The new ones had emerged in the wake of changed economic policies in each of the countries. Others had changed hands more than once, having either been privatised at some point of time from public sector ownership or just sold to new owners. It must be admitted that the project could not penetrate the export processing zones, which had been one of its original intentions. Even non-union enterprises could not be selected, due to management apprehensions about unions, except for one in Bangladesh.

Country	Industry	No of Employees
India	Utility Vehicles	3197
India	Watches, Jewelry	3097
India	Automobiles, Heavy Vehicles	12000
India	Lubricants, containers	104
India	Moulded Luggage	450
Bangladesh	Pharmaceuticals	452
Bangladesh	Export Garments	180
Bangladesh	Synthetic textiles	1280
Bangladesh	Jute	4400
Bangladesh	Hospitality	527
Nepal	Export Garments	927
Nepal	Hospitality	699
Nepal	Jute	1925
Nepal	Soaps & Detergents	160
Sri Lanka	Rubber	1070
Sri Lanka	Telecommunications	8798
Sri Lanka	Porcelain	1024
Four countries	**Thirteen** industries	Over **40,000** employees

Project Teams were appointed for each country in consultation with the local ILO office, including a national coordinator who visited the enterprises selected and provided guidance about participation, workshop preparation and subsequent follow up on action plans. The next step involved designing a series of three workshops for each country so that the enterprises would not only be exposed to social dialogue practices and methods but also learn from each other. The last step was to conduct these workshops.

THE WORKSHOPS

The workshops [at intervals of 5-6 months] were designed to bring together about four representatives [two from management and two from union] from each enterprise in a common forum in each country. At the workshops, they would jointly, or in groups identify their own challenges, devise their own methods of consultation, and establish their own systems for workplace dialogue. During the process, they would learn to take interest in each other, learn from each other, and learn how to consult among themselves to arrive at a decision or learn how to work together. It was also necessary to visualise a warm, supportive yet non-partisan role for the project personnel conducting the workshop, so that they did not

intrude into the enterprise' decision-making process. At the same time they should be available to ask indicative questions, smoothen out deadlocks or bottlenecks and encourage openness.

The workshop designs combined a mix of plenary sessions and group work with a minimum of lecture sessions, and with the participants themselves being resource persons. The participants were not only put into their own enterprise groups but also into mixed groups with managers and employees from different enterprises and into homogeneous groups of all managers or all unionists. The workshops would also become training opportunities for the participants on how social dialogue starts, develops and institutionalizes.

The two-day workshops were spread over a period of 9 months to one year. The original objective was to have uniform gaps between each workshop in one country. However, as is obvious, uniformity was difficult to maintain, since it depended on the project teams, the convenience of all the enterprises selected, and availability of premises. The complete schedule was as follows :

Country	Time and place of First Workshop	Time and Place of Second Workshop	Time and Place of Third Workshop
Bangladesh	December 1999, Dhaka	June 2000, Dhaka	November 2000, 40 KM from Dhaka
India	December 1999, Mumbai	November 2000, Mumbai	April 2001, Hosur, Tamil Nadu
Nepal	June 2000, Katmandu	September 2000, Katmandu	January 2001, Pokhara
Sri Lanka	March 2000, Colombo	November 2000, Colombo	March 2001, Colombo

The **First Enterprise Workshop** of two full days of six sessions was designed to acquaint the participants with each other, and about the objectives of the project, and to provide an opportunity for them to learn about social dialogue through practice. The specific objectives were :

- Identify challenges for the enterprise through social dialogue,
- Formulate action plans and projects to meet these challenges through dialogue, and implement such innovative actions
- Create a dialogue between enterprises for mutual learning and exchange of information

The workshop also aimed at bringing out into the open participants' expectations about the project, about each other and about ILO's role.

The **Second Enterprise Workshop** was designed to analyse the dialogue process itself, by identifying the new parties brought into dialogue

[beyond the traditional parties], the changes in the process itself and the inhibitory factors, the new issues included in dialogue, and the benefits obtained by the enterprise and the parties through the process. Its specific objectives were :

- To consolidate the project which had already been launched in the country and to improve the participants' understanding about the dialogue process
- To explore and evaluate existing dialogue processes,
- To revise the existing action plans,

The **Third Enterprise Workshop** had as its main objectives :

- The development of Policy for sustaining dialogue within enterprises and for its monitoring
- The development of policy/systems for disseminating experience gathered so far among other enterprises or to start a national dialogue
- The development of systems for sustaining dialogue among the selected enterprises, in one country and among the countries

THE SOUTH ASIAN EXPERIENCES

In **Bangladesh** out of the six enterprises suggested by the Employers' Federation, only one finally agreed to be part of the project. Four others were roped in through personal contacts of project personnel or local ILO office to make a total of five. A great fear of unions was encountered among many of the enterprises approached. None of the units were very large, compared to the Indian enterprises, nor conversant with the latest management techniques. Four of them had periodic collective bargaining. These enterprises had previously very little experience of any consultation or any union-management relations other than collective bargaining and on very basic issues. The unions also had little idea about the emerging challenges of liberalisation and globalisation. Thus each of the workshops were for both management and unions, training grounds not only in social dialogue, but in mature labour-management relations and consultative processes in the context of changing economic situation.

Each of the enterprise groups exhibited their own styles, but at the workshops they proved eagre to learn. If one enterprise presentation was made partly by its employee representatives, subsequent presentations by other enterprises, followed the same pattern. This demonstrated learning through action. Candid admissions by one enterprise encouraged transparency among other enterprises. Questions asked after presentations, indicated eagerness to learn and understand and also the freedom of CBAs to reply. But there was some indication that specific questions were either not understood or deliberately avoided.

Initially, it was clear that dialogue within enterprises was mainly confined to senior managers and top unionists and the process imperfect. They were comparatively less open. Communication was slow, sometimes deferred. Some presentations were too good to be true – everything appeared to have been done. In most cases management initiated dialogue. There was a mix of both formal and informal dialogue. Inhibitions identified were inarticulateness, fear, absence of perception. **Issues** identified by participants in the first workshop were generally conventional. The Bangladesh enterprises could envisage some permanent structure for regular dialogue within their enterprises only after the third workshop. One enterprise proposed to form a joint committee consisting of 30 (15 managers +15 unionists) members to discuss on specified days of the month, productivity improvement, skill development, new technology, training, staff grievances, and other emerging issues.

In **India**, five enterprises were selected by the Employers' Federation of India [EFI]. All were large established industries located in the western and southern part of India. They were less varied than those selected in the other three countries. Most of them had one recognised union and a few had other unions too. All the unions were strong and vocal. At the first workshop in end 1999 they appeared to have made significant changes already in their workplaces as a result of existing dialogue. All of them gave several examples of positive tangible benefits derived from dialogue. The issues appeared to range from work reorganisation to pollution control to family welfare. Both the unions and the management found the process of social dialogue very advantageous in bringing about change in the attitudes of the workers and management, increased communication and transparency in the organisation. Active participation had strengthened their mutual belief to co-exist and survive against the challenges of the environment. The major obstacles they had faced included negative mindset of some employees, management of the old and untrainable employees, and distortion of information by press, rumour-mongering and negative propaganda by disgruntled employees.

But with regard to the process of social dialogue, the participants admitted major changes in the way dialogue used to take place traditionally and the process that was being followed after the workshops. Overall, the organisations felt that the scope of dialogue [the partners involved had increased] and the system had become much more flexible and were no longer determined by hierarchy. Several issues relating to productivity, performance, quality, safety, redesigning of jobs, redeployment, transfers, welfare facilities and so on had been tackled. Both parties were initiating dialogue. The frequency of the dialogue in almost all enterprises was daily, weekly, monthly as well as need based. They said that the major outcomes

of the workshops had been change in the attitudes of unions and management, stable industrial relations, increased trust between management and workers and transparency. Physically, there was reduction in product rejections, increased productivity, quality, multi-skilling, and monetary gains to the workers. They also expressed considerable satisfaction at the learning experience of the workshops, especially what they learnt from each other.

In **Nepal**, the selection of enterprises was arduous, to say the least. The project team had about 100 interviews before six enterprises could agree to be part of the project. It was obvious that the IR situation in Nepal was not very conducive to cooperation and dialogue. While employers generally accused labour of indiscipline and poor productivity, labour accused employers of exploiting them. Bad working conditions, job discrimination and insecurity, poor pay and wage inequality and displacement of Nepali labour with foreign workers were some of the accusations. Average employment per enterprise had declined from 135 in 1991/2 to less than 100 in 1999/00.

However, at the end of the three workshops the participating enterprises not only had plans for establishing regular dialogue within their system, but also plans for training their own employees and for holding workshops to create awareness among 4/5 other enterprises in their own locality. Most of the issues identified by managers were conventional, such as discipline, productivity, quality, and understanding of recent changes. The issues identified by workers were also usual, like remuneration, promotions, overtime payments, leave, allowances etc. But, as the workshops helped them to focus attention on the real challenges ahead, the issues became much more related to efficiency, productivity, quality, job rotation, employment composition and so on. Competition, computerisation, costs, work culture, technology, training also emerged.

During the second workshop, when the analytical framework was applied by the participating enterprises to their dialogue experience it was found that for most, existing dialogue was confined to senior and top management levels and trade unions. In some, this was supplemented with dialogue between unions and supervisory or welfare personnel. It was admitted that lack of transparency hampered dialogue. The results were usually compromises rather than rational decisions. In contrast to this, at the end of the third workshop, participants listed the specific benefits achieved through the workshops as :

1) Two sides lost their fear of each other. Earlier, whenever TUs wanted to talk, management apprehended demands. Now there was better understanding of each other ; sounder IR, better productivity and improvement in leadership.

2) Attitudes had changed. Unions said that informal interaction had increased, and they themselves were more aware of individual worker differences and had accordingly changed their methods of convincing them. More women had been inducted. The labour relations committees had become more active.
3) Productivity had increased, absenteeism had been controlled and reduced substantially, management had been successful in persuading political leaders about requirements of recruitment in terms of skill. Unions felt that more discussions were held with workers now, even on production matters and more suggestions were being taken from them.
4) Workers were also more committed and concerned about enterprise survival.
5) In one enterprise, new machinery had been introduced, a welfare fund to be managed by workers created, and two committees established. One of these committees would deal with Evaluation and one with Factory Improvement. The unions had agreed to these committees to convince the owner that workers were also concerned with production and not merely with their demands.
6) With regard to dissemination plans, the four enterprises decided to organise six workshops involving a total of thirty workplaces to disseminate the idea of social dialogue. Four of these have already been held, in which the participating enterprises have taken the initiative to show other enterprises how to use dialogue.

In **Sri Lanka** there were major problems in identification of enterprises as several opted out after initially showing interest. Ultimately, four enterprises were identified and selected for the project, of which again one dropped out later. Two of the remaining three had been public sector units earlier and had been privatised in 1992 and 1996. All the enterprises indicated that they already had various consultative practices like quality circles, joint committees, union management meetings etc. Only one admitted only union management meetings and nothing more. However after the first workshop, the progress in the enterprises was not uniform nor their methods the same. While one unit concentrated on formation of workgroups or teams at shop floor level, another put more emphasis on achieving productivity gains and creating a new work culture. The third drafted guidelines for customer relations and a grievance procedure, with the help of union representatives.

Managers and unions agreed a sense of ownership had been created through dialogue and knowledge on the competition had improved. The constraints were the cultural differences between management and workers and the existence of sub-cultures, financial difficulties and lack of time.

It was observed, however, that constraints were treated as real and practical while opportunities were looked on as theoretical. In all the three enterprises the existing dialogue was mostly formal and channeled through union-management meetings – the conventional mechanism for labour management consultation. There was also resistance from some employee groups and vague delineation of responsibilities for implementation of action plans. Replacement of delegates at the first workshop with others who had no clear idea about the project, at the next, was another problem in one enterprise.

In general, the ILO initiated dialogue appeared to have operated more as a peripheral activity in the management of employee relations in all the three enterprises at the beginning of the project. This was clear from the nature of issues taken up for the dialogue and also from the attitude and commitment shown by both groups to follow up the enterprise action plans. More specifically, the unions observed that declining profits and reduction in bonus payments made employees less receptive to the idea of promoting employer-employee dialogue. However, by the third workshop, the participants emphasised the benefits they had got out of the dialogue process. Two of them gave several illustrations of the benefits derived. They felt management attitudes had changed considerably and they were much more responsive to union or employee problems. Both these enterprises had substantial union representation in the workshops.

BENEFITS OF THE DIALOGUE PROCESS AND GENERAL LEARNING

All 17 participating enterprises acknowledged that they had obtained several benefits from the dialogue processes started. Some were tangible, others were less tangible but quite real, such as attitudes, harmonisation etc. The unions got an opportunity to sit on an equal footing with management to discuss issues relating to their enterprises. All the enterprises got an opportunity to learn from each other. Much of the behaviour during the workshops was learned from other enterprises. They learned about talking, about sitting together, about arriving at decisions together, and about presentations by all members of the team.

Common benefits identified by participants in all countries were :

- mutual understanding was created and maintained
- industrial peace was maintained. Little or no unrest occurred after dialogue started
- forums were created for listening to each other
- overall progress of industry, workers, owners and managers was achieved

- productivity increased
- confrontation was removed or minimised
- feelings of job security were created
- gap between managers and workers was bridged
- communication skills improved
- negotiation skills developed
- problems among workers were identified
- transparency improved
- good working environment was created
- skills improved
- implementing good practices and removing bad practices was facilitated
- the enterprise was helped to look beyond legal aspects

All the enterprises learnt that social dialogue was not an exotic concept, as had been the case earlier with participative schemes, but a daily occurrence where two sides could sit down together and discuss any issues. Most existing discussions in enterprises already had two sides. But the conventional process was that one party usually dictated to the other or one refused to listen to the other. The workshops allowed both parties to have their full say without interruption from the other. Employees who were not represented by unions got an opportunity for the first time to express their opinion in a public forum and were encouraged to learn that they too could have rational arguments. They learnt that they were not alone in their problems. The workshops also demonstrated that for social dialogue to be effective, two parties,

- needed an objective [task set at the workshop],
- were equal in their capabilities [no discrimination or status differential was allowed in the workshops],
- could gain from the joint decisions, and
- were jointly accountable for these decisions [critical questions were asked at the workshops for clarifications].

This basic learning was demonstrated again and again.

As may be observed from the strategies outlined at the outset, involving women more in the dialogue process and in the project, was one of the key strategies. In pursuance of this, gender sensitisation was introduced into the project shortly after its launch. This was part of the project methodology, where the national project coordinators were included in the decision making process about the implementation of the project. Hence, at the first team meeting in March 2000, the need to consciously expose more women to the project and get them to actively participate was highlighted.

The results were fairly immediate. Workshop participation of women increased significantly. In Bangladesh, it increased from two in the first workshop to five in the second. In Sri Lanka, participation of women increased to 8 out of a total 27 participants in the second and third workshops. There was a larger number of women in Nepal's second and third workshops too. Ironically, there was no female participation at all, however, in the workshops in India except right at the end. Even more enduring, was the fact that some of the participating companies started a recruitment process for women, inducting larger proportion of women into their enterprises. One enterprise in Bangladesh recruited 20 women by the end of the third workshop.

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PERFORMANCE RELATED INCENTIVE SCHEME FOR HOTEL INDUSTRY PERSONNEL IN KOLKATA : A CASE STUDY

SHARMISTHA BANERJEE

INTRODUCTION

The most prominent historical views of human nature are based on the assumption that people are essentially rational beings with conscious desires and capacities to fulfil these desires. The ancient Greek philosophers used the principle of *hedonism*, which states that individuals seek pleasure and avoid pain. However, it is far to simplistic to adequately explain the complexity of human nature in today's world. Other theorists have conceptualised intrinsic motivation in terms of generalised needs and affects, which are psychological rather than physiological in nature, a significant development after hedonism.

However, it is evident that money is important to employees for a number of reasons. Certainly money is valuable because of the goods and services it can purchase. This is its economic value as a medium of exchange for allocation of economic resources. Nevertheless, money is also a *social medium of exchange*. Money has status value when it is received and when it is spent. It represents to employees, what their employer thinks of them. It is also an indication of one employee's relative status compared with that of other employees.

In the workplace, incentives are arrangements of financial and / or non-financial nature given to stimulate human effort and effectiveness. Management must continuously endeavour to improve labour effectiveness by creating an environment congenial to the workforce. As a result, reduction in labour costs may also be anticipated. Though it may be considered that providing improved equipment can bring about increase in labour efficiency, by the adoption of better methods and by more effective utilisation of plant; but the most important contribution must come from labour, *per se*.

Accordingly, every system of personnel remuneration must be so designed as to motivate the individual to do his best. The payment of low wages may apparently seem to yield low people costs, but this is not generally the case because high wages tend to attract the best workers and

monetary as well as non-monetary incentives gives an added encouragement to increase productivity. This idea is backed by various motivational theories, which establish that employees respond not to money alone, but also participative decision making and recognition as a reward for efficiency in service.

In this backdrop, the hotel industry has been studied through a survey of four five-star category hotels in Kolkata. An incentive scheme related to employee performance specifically suited for the needs of the hotel industry has been designed out of the survey findings. One need not be reminded that the hotel industry, being a significant part of the services sector, deals mostly in intangibles. Analysing the findings of the survey, an attempt has been made, in this article, to sketch a performance related incentive scheme suitable for motivating personnel working in the hotel industry, where it is difficult to bring about objectivity in performance evaluation. This sector, could therefore ideally benefit from a standardised performance related incentive scheme, such as the one suggested in this paper.

THEORETICAL BACKGROUND

Each individual tends to develop certain motivational drives as a product of the cultural environment in which that person lives and these affect the way he views his job and approaches his life. Studies by David C. Mc. Clelland of Harvard University revealed that people were motivated by drives for achievement, affiliation and power. Achievement motivation is a drive some people have which enables them to overcome challenges and obstacles in pursuit of their goals. An individual with this drive wishes to develop and grow and advance up the ladder of success. Achievement oriented employees maintain a symbolic score card in their minds by monitoring their total remuneration and comparing it with others. It is a measure of their accomplishments. Monetary compensation also relates to other drives, since it can be used to buy ones way into expensive clubs (drive for affiliation) and give one the capacity (drive for power) to influence others.

In the *Herzberg* Model, pay is primarily viewed as a hygiene factor, although it may have, at least in the short term some motivational value as well. The motivators, primarily are the non-monetary incentives, which come in the form of recognition of efficient performance. In the other need-based models, pay is most easily seen in its capacity to satisfy lower order needs (like *Maslow's* physiological and security needs). However, one can easily observe how it relates to other levels, like esteem needs.

Pay also relates to the *attribution model*. The model assumes that most employees want more money than they are now receiving. When evaluating their successful performance, they tend to attribute it to ability or skills, which are, legitimate bases for receiving additional rewards. When explaining unsuccessful performance, they attribute those to overly difficult tasks or bad luck. These are both factors that are beyond their control and presumably, would not be punished by the employer by withholding rewards.

As one may recall, *Expectancy Theory* states that Valence × Expectancy × Instrumentality = Motivation. This means that if money is to act as a strong motivator, then an employee must want more of it (valence), believe that effort will be successful (expectancy) and trust that monetary reward will follow better performance (instrumentality). Management does not easily influence valence of money. It is contingent upon an employee's personal values, experiences and needs as well as the macro-motivational environment. The direct value of money to people in an affluent society tends to decline, since money tends to satisfy lower order needs. However, since money has different social meanings to different people, employees may seek it for its social value even when it's economic value has low valence.

Such studies imply that money is the chief motivator, though not the only motivator. Thus, non-monetary incentives which not only come in the form of perquisites but also in the guise of participation in decision making, improvement in status or promotion in the hierarchical structure are significant influencers of employee performance.

Incentive schemes related to performance evaluation can provide a challenge to motivate workers. The harder one works the greater the financial and non-financial rewards that follow. When an incentive scheme is designed keeping in mind the specific industry profile to which it is to be applied, the employee's personal objective of adequate motivation and reward will complement the employer's objective of cost minimisation, thus achieving goal congruence. A higher level of productivity leads to reduction in cost per unit especially in the services sector, where fixed costs constitute a relatively large portion of total cost. In turn, this will match shareholder's objective of adequate returns on investment.

The service sector, which is under study in this paper, undoubtedly is growing in importance in all economies through out the world. Thus, a study on employee motivation at this juncture of world economy is probably not purely an academic exercise. The integrated service industries comprise over half of the total workforce of the USA (Vallen, 1978). Although growth has been phenomenal, segments of the industry have lagged in implementing modern management methods and technology, which is essential to keep the business competitive.

NEED FOR A SPECIFIC INCENTIVE SCHEME FOR THE SERVICE SECTOR

In this article the hotel industry has been chosen to represent the typical pattern of the service sector. The hotel industry is a part of the hospitality industry that also includes motels, hospitals, clubs, commercial restaurants, canteens, etc. Besides offering services that are intangible, abstract and hence, difficult to quantify, the workers in the hospitality sector are basically divided into front-of-the-house and back-of-the-house staff. One group of workers maintain direct contact with the customers while another group supports the first. This is a common and essential organisational division for task accomplishment in this sector.

Due to its peculiar characteristics, the services sector in general and the hotel industry in particular, is unable to introduce generally accepted incentive wage plans. Under direct financial incentive plans compensation paid to a worker is commensurate with his output, which cannot be objectively measured in the hotel industry. Indirect financial plans are therefore need to be adopted with necessary modifications, to suit the character of the industry. These are expected to improve productivity by stimulating the workers' morale. Such incentive schemes may take various forms that include fringe benefits, suggestion and reward schemes, promotions, unexpected raise, etc. This intends to create worker motivation through participation in management and significantly contributing towards the overall success of the hotel.

Indirect incentive plans and productivity related pay schemes may be introduced to provide the dual benefit of performance evaluation and team motivation, one obviously leading to the other. But the problem of incentive scheme introduction takes a more specific form for the service sector industries wherein; measure of productivity is *subjective* and *abstract*. Since the service sector provides basically below the line services which are *intangible* as well as *invisible* in most cases, it posses an unique problem to the employer who has to motivate his employee by providing incentives on the basis of the service provided by that employee. Therefore, incentive schemes have to be outlined to suit the character of work in the hotel industry.

In addition, the importance of fringe benefits which comes by way of performance related incentive would rather not be underestimated, specially because in a labour intensive industry involving high degree of customer-worker contact, the contrast between the guest's environment and his own can become a major source of discontent. Therefore, the performance related incentive schemes like the one proposed in this paper is intended primarily to motivate employees to give better performance and contribute towards the gross overall performance of the hotel.

It is common practice in many hotels, that the front-of-the-house staff are able to augment their take-home packet by earning additional payments in various forms. The simplest form of incentive payment in the hotel industry originated by way of 'tipping', when workers in the 'inns' were not employed by the inn keeper but were retained by guests to do particular jobs such as carrying bags, cleaning garments, etc. It also grew up in an age when it was normal to motivate people by fear. In the case of tipping, the threat of the tip being withheld was used and because there was probably no other income, the man's means of income was jeopardised (Boella, 1983). But it may imply sheer anarchism. Though a more refined version of tipping is still very much in practice in the hotel industry, but tips are collected in a pool and distributed among the workers in a mutually agreed pattern. Thus, the tip no longer acts as the motivator behind or the reward for excellence in service, as it takes the form of a general incentive being distributed without recognition of each individual's efficiency in service.

In order to implement an organised performance related incentive scheme, it is important to quantify the services rendered in some measurable units with some minimum degree of subjectivity. In this paper, the situation is studied by way of a survey of the HRD sections of four Five-star category hotels in Kolkata wherein, the guest has a pre-conceived expectation in his mind as regards the kind of service he expects in lieu of the tariff of the hotel. The employees are expected to fulfil these perceived requirements of the guest and as such the customer satisfaction is to be measured in order to arrive at the results of the performance evaluation scheme.

Such performance based incentives pose unusual problems that may be solved by devising schemes that can be based on "guest compliments" and "guest complaints", as suggested in this paper, following the Survey findings.

THE SURVEY

A survey taking the sample as 4 of Kolkata's Five-star category hotels, namely, *The Grand*, *The Park*, *Taj Bengal* was conducted. To get an overall view of the performance of staff in different kinds of hotels, a resort hotel, *Radisson Ffort* was also surveyed.

The HRD managers responsible for employee development were interviewed. A series of discussions yielded lacunae in the area of performance related incentive schemes for personnel motivation.

The chief observation, practically undisputed, was that the hospitality industry is essentially a service sector industry whose dealings in invisible

and intangible products makes it difficult for a specific unit to be identified for employee performance evaluation in any of the departments in the hotel.

A hotel has many functional departments like Front Office, separate kitchen for each of the Restaurants, Room Service, Housekeeping, Engineering, Food and Beverage, Purchases, Systems, Accounts, HRD, Public Relations, etc. The work of each departmental staff was so closely related to each other that it is difficult to identify a particular area and evaluate individual performance. This complicates matters further when there is need for reward of incentive on the basis of performance.

One of the chief findings of the survey is explained with the help of an example. Considering the case of one department of the hotel, namely engineering. It may be noted in this context that an engineer serving the maintenance department is responsible for the electrical, mechanical, electronic, air-conditioning, telephone, kitchen facilities of the entire hotel – all restaurants, all rooms and so on. There are three main reasons behind this choice – firstly, all departments and all services rendered in the hotel are closely associated with this department and are often found to seek their help. Secondly, being the engineering department it deals with activities of a more generalised nature like the installation and upkeep of the airconditioner machine, transformer, boiler maintenance and all other laundry and kitchen gadgets in use in the hotel. Thirdly, in spite of being a back of the house department, with little scope of direct interaction with guests, their activities are specially important as they involve the basic infrastructure support. An agreement may be drawn up between the management and the in-charge off the Engineering department so as to make an objective evaluation of the staff activities possible. For example, in the area of energy saving a cost benefit analysis may be done comparing costs of energy saving devices installed and the resultant decrease if any on power bills. In the area of machine breakdown, a stipulated number of breakdowns may be considered allowable in a specified time period, exceeding which the concerned personnel may be held responsible. Intra-departmental cordial relationships and the ability to train a second-in-command are considered added qualifications for employees of every department. Since the Engineering Department personnel need to interact closely with the staff of all other departments their attitudes and inter department relationship can also be monitored. On the other hand, other departments like the Coffee Shop can base employee evaluation on the basis of customer complaints and revenue generation, the Kitchen on energy saving customer satisfaction, reduction of food cost and accident free man-hours, so on and so forth. Similarly Systems and Purchases departmental activities spread their wings on all spheres of the hotel.

Therefore the employees of such departments provide services for which all other departments become the internal customers. Therefore, it is important that the performance of such employees be monitored, duly improved and rewarded.

The managers interviewed, in-charge of HRD section of all the four hotels were unanimous in their view that the personnel department is interested in implementing schemes for motivating the staff to bring about an involvement on their part for the overall improved functioning of the hotel. This would require employee participation in decision making and hence such plans, which when formulated in consultation with employees, will face more ease of application.

Observing the enthusiasm of the HRD managers in relating incentives to efficiency in performance and the absence of such a scheme which could be standardised for the hotel industry, a scheme has been drawn out, which aims to bring about continuous improvement among employees. There are no fixed bonuses for executives, only performance related non-monetary incentives are given according to grades obtained and scoring, the minimum levels of which are also fixed, so that below average workers are given the necessary warning. At the same time no worker is allowed to stagnate, as there is a continuous pressure for achieving higher goals.

A SUGGESTED INCENTIVE SCHEME

A scheme may be introduced to bring out the best efforts of the employees and draw their utmost contribution to the gross overall performance of the company. It tries to bring about a team spirit so that the best efforts of the staff are put forth in contributing towards the goodwill of the hotel.

It is a programme that links "customer delight" with "employee recognition". The company recognises and appreciates and hence duly rewards an employee who brings delight to the customer. So a guest's satisfaction is the reward for the employee's efficiency. This is undoubtedly a novel and meaningful way of motivating employees. Such thoughtful and sensitive motivation may not always be possible through direct monetary incentives.

The objectives of the programme are to :

- have a fair and transparent system of recognising efficiency in performance;
- extend opportunities for "heart of the house" areas to delight the customers;
- acknowledge excellence in service;
- encourage staff involvement in all activities of the hotel and

• make excellence a way of life.

The basis of this programme is the recognition of excellence in service of staff, specially those serving the various areas of the hotel in handling of external customers (guests) and internal customers (co-employees / other departments).

The process is so designed that an employee keeps gaining points for the good work done. The scheme offers no direct monetary raise, promotion – but offers incentives in the form of titles. The titles in the offer are *Star*, lying at the bottom most rung of the ladder, just on top of which falls the *Nova* and at the apex is *Supernova*.

SUPER NOVA (Consistency in excellent performance)

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NOVA (Excellence over longer period of time)

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STAR (First signs of excellence)

TOOLS IN IMPLEMENTING THE SCHEME

For the operation of the suggested incentive plan, three tools, namely, Guest Compliments, Distinction Cards and Suggestion Schemes have been proposed to be used. Guest Compliments are written communication appreciating the services rendered by an employee. They may come through Guest Comment Cards, which are used as a point-of- exit survey or voluntary personal notes and letters from guests. Once an employee receives a Guest Compliment he has to report to the Programme Coordinator. The coordinator starts making a record for each employee from the date of his first receipt of such a compliment. He intimates the employee through a 'Recognition Card' for having received the compliment. As a result both the performer and the evaluator have a record of their own. This process will continue as and when employees get Guest Compliments. The coordinator will give a card each time an employee receives a compliment and maintain a record of the same. Upon receipt of 4 such compliments within a period of four weeks an employee wins the title of Star and then rewards continue to follow. Further when an employee gets 1 Guest Compliments per week for four out of next six weeks, after obtaining Star, he receives the title of Nova. Further, in the next twelve weeks, to qualify for the title of Supernova he must get 2 Guest compliments per week for six weeks.

But Guest Compliments are inaccessible for the back-of-the-house staff, those who have no opportunity to interact with the guests, like the kitchen or the systems staff, who deal mainly with the internal customers. It is for these employees, who form a significantly large proportion of the total work force of a hotel, that the Distinction Cards and the Suggestion Boxes are used. Though employees with direct guest interaction opportunities are not excluded from the Distinction Cards and Suggestion schemes.

Distinction Cards are given to employees who are found doing extraordinary work. This involves an out-of-the-way service to a guest or a colleague. The internal co-ordination of a hotel is of utmost importance for the satisfaction of the guest. Thus a tool like Distinction Card is expected to encourage an employee to be alert to the needs of the guests and other employees/ departments. They are given by appointed 'Co-ordinators', generally Heads of Departments. They are floating all the time carrying Distinction Cards to be awarded to employees found to be doing extraordinary work, on the spot. Generally Co-ordinators are ones who appreciate and acknowledge the contribution of employees from their own as well as other departments. Such Co-ordinators are periodically changed in order to avoid bias and maintain transparency. To go up the ladder using these Distinction Cards, an employee must get 4 Distinction Cards in four weeks to receive the title of Star; 1 Distinction Card per week for four weeks in the next six weeks to receive the title of Nova and procuring 2 Distinction Cards per week for six weeks in a period of next twelve weeks after becoming Nova will fetch him the title of Supernova.

Suggestion Schemes are open to all employees likewise. The suggestions may be routed through Quality Circles, as regards problems faced in matters of day-to-day functioning. On the other hand, suggestions in areas of revenue generation and cost control are always welcome and may be dropped in requisite suggestion boxes with the name of the employee proposing the change. The suggestion boxes are reviewed at regular intervals by coordinators appointed for the purpose, so that maximum suggestions can be tested for their validity. Again to go up on the ladder, 2 accepted suggestions coming from one employee in a period of twelve weeks fetches him the title of Star, 4 in the following twelve weeks makes him Nova and to become Supernova an employee needs to have 6 of his suggestions accepted in the next twelve week period.

It must be clearly understood that these titles carry no direct monetary reward or are not accumulated to yield promotional benefits, but are merely status symbols in the hotel hierarchy. They make employees more committed as they get attracted towards these titles and the fringes that go with it. The Star holder is invited to tea with the General Manager, gets badges to wear at work, gift vouchers or family dinner invitations to the

inhouse Restaurants. The higher the title the higher such prestige symbols and thus more motivated the team of workers.

The above mentioned scheme tries to give an idea that the back room hotel staff play an equally significant role behind the curtain as say the Front Office staff who are actually serving the guests through their direct efforts.

Undoubtedly, all personnel in a hotel, whichever departments they may be serving need to be motivated with adequate incentives in order to fulfill their team objective of guest satisfaction.

A hotel may, therefore adopt such a scheme for :

- co-ordinating the work of different departments (Co-ordinator of one department distributing Distinction Cards to workers of all departments including his own);
- ensuring cordial inter department relationships (satisfaction of internal customer being a key area of personnel evaluation);
- keeping an employee alert throughout his working day, not only in specific area of work but during his entire presence in the work place (floating Co-ordinators distributing Distinction Cards);
- involving staff think-tank in bringing about improved work practices (by way of inviting suggestions);
- keeping staff continuously involved in a perennial process of improvement (proceeding from Star to Nova);
- preventing stagnation by pressurizing an employee to reach higher levels of achievement (given time limit and target);
- making the employee participate through suggestion schemes (ensuring ease of implementation of suggestions).

The scheme is expected to go long way in motivating employees towards a team effort required for the overall image building of the hotel.

GENERAL APPLICABILITY OF THE SCHEME

In this context, it is important to note that such schemes and especially the essence behind them can be applied, not only to the hospitality industries, but also to other units in the services sector. In the hotel industry, as well as the hospitals or any other public utility service, the employees aim at guest or patient or customer satisfaction, but it is equally difficult to pin down responsibility and accountability. In such a situation, the subjective atmosphere makes it difficult to evaluate the contribution of one employee in the total performance of the unit. It is only through such schemes that the employee can be motivated and duly rewarded for his enhanced participation and positive contribution towards the overall benefit of his enterprise. Any unit in the services sector can design a

scheme keeping in mind the employee psychology matrix, objective and work culture of the organization and previous incentive plans, if any. Moreover, such practices can be extended to all public utility services where the services provided are not measurable in purely defined units and the behind the screen staff play a key role in the success of on stage players.

LIMITATIONS

Such incentive schemes, however, face some limitations, in the sense that, the enterprising employees will enthusiastically participate in the schemes, but the ones with lack of initiatives will abstain from joining such ventures. As a result, though such employees can be identified, there can be no way to compel them to work harder.

There may be employees who never exceed the allowable number of break downs or are never the cause of guest complaints but are not motivated enough to contribute positively towards the gross overall performance of the unit. They probably remain the Theory X workers who never aim to achieve the top of Maslow's pyramid.

On the other hand, these incentive schemes being partially based on guest's reaction is subject to severe subjectivity. The guests, who are the evaluators of employee performance, are from different variety of backgrounds with differing perceptions regarding the kind of service expected. Thus, the employee is subject to a series of evaluators who put in complaints and compliments without any common denominator.

The portion of performance evaluation carried on by Marshals or suggestion schemes are also not entirely objective either, due to the absence of a common yardstick which is an inherent defect of the services sector.

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